United States Court of Appeals

for the Second Circuit

JOINT APPENDIX

76-7278

Volume A-4
Page A-211(1022) to A-211(1430)

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 76-7278

B

MARGARET MARY MCDONNELL MURPHY,
Plaintiff-Appellant,

against

MCDONNELL & CO., INCORPORATED and THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, President,
Defendants.

JAMES F. MCDONNELL, JR., individually, as Trustee under the Will of James F. McDonnell and as Executor of the Estate of Anna M. McDonnell, and CHARLES E. MCDONNELL, as Executor of the Estate of Anna M. McDonnell,
Plaintiff-Appellants,

against

THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, THE NEW YORK STOCK EXCHANGE, INC., THE AMERICAN STOCK EXCHANGE by H. VERNON LEE, JR., Secretary, and MCDONNELL & CO., INC.,
Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

JOINT APPENDIX (Vol A-4)

DAVIS & COX
One State Street Plaza
New York, N. Y. 10004
Attorneys for Plaintiff-Appellants

MILBANK, TWEED, HADLEY & MCCLOY
1 Chase Manhattan Plaza
New York, N. Y. 10005
Attorneys for Defendant
New York Stock Exchange, Inc.

LORD DAY & LORD
25 Broadway
New York, N. Y. 10005
Attorneys for Defendant
American Stock Exchange

PROSKAUER, ROSE, GOETZ & MENDELSOHN
300 Park Avenue
New York, N. Y. 10022
Attorneys for Defendant
McDonnell & Co., Inc.

UNITED STATES COURT OF APPEALS
FILED
OCT 12 1976
A. DANIEL FUSARO, CLERK
SECOND CIRCUIT

October 8, 1976.

PAGINATION AS IN ORIGINAL COPY

LIST OF CONTENTS

Volume I

	Page
List Of Relevant Docket Entries	A-vi
Order Consolidating Civil Actions 71 Civ. 461 And 71 Civ. 1940 For All Purposes, Dated April 13, 1973 [Doc. 150]	A-1
Murphy Amended Complaint [Doc. 174]	A-3
Answer Of NYSE To Murphy Amended Complaint [Doc. 175]	A-25
Answer Of McDonnell & Co. To Murphy Amended Complaint [Doc. 177]	A-31
McDonnell Amended Complaint [Doc. 203] ...	A-39
Answer Of NYSE To McDonnell Amended Complaint [Doc. 164]	A-75
Answer Of McDonnell & Co. To McDonnell Amended Complaint [Doc. 204]	A-83
Answer Of Amex To McDonnell Amended Complaint [Doc. 205]	A-97
Plaintiffs' Request To Charge [Doc. 187]..	A-109
Plaintiffs' Supplementary Request To Charge [Doc. 193]	A-153
NYSE'S Request To Charge [Doc. 206]	A-171
NYSE'S Supplemental Request To Charge [Doc. 188]	A-201
NYSE'S Second Supplemental Request To Charge [Doc. 189]	A-203
NYSE'S Third Supplemental Request To Charge [Doc. 190]	A-207
NYSE'S Fourth Supplemental Request To Charge [Doc. 209]	A-209

Page

Transcript Of Trial, Opening Statements Of Counsel, April 28, 1975 [Doc. 147] .. A-211(1)

Transcript Of Trial, Testimony Of Margaret Murphy, April 28, 1975 [Doc. 147] ..... A-211(34)

Transcript Of Trial, Testimony of Margaret Murphy Continued, April 29, 1975 [Doc. 147] ..... A-211(103)

Transcript Of Trial, Deposition Testimony Of Anna McDonnell, April 29, 1975 [Doc. 147] ..... A-211(198)

Volume II

Transcript Of Trial, Testimony Of James F. McDonnell, Jr., April 29, 1975 [Doc. 147]..... A-211(245)

Transcript Of Trial, Testimony Of James F. McDonnell, Jr., Continued, April 30, 1975 [Doc. 147) ..... A-211(263)

Transcript Of Trial, Testimony Of James F. McDonnell, Jr., Continued, May 1, 1975 [Doc. 147] ..... A-211(456)

Transcript Of Trial, Testimony Of Andrew R. McElroy, May 1, 1975 [Doc. 147] ..... A-211(591)

Volume III

Transcript Of Trial, Testimony Of Andrew R. Mc Elroy, Continued, May 2, 1975 [Doc. 147] ..... A-211(650)

Transcript Of Trial, Testimony Of Andrew R. McElroy, Continued, May 5, 1975 [Doc. 148] ..... A-211(740)

Transcript Of Trial, Testimony Of Herbert E. Schuette, May 5, 1975 [Doc. 148] .... A-211(810)

Transcript Of Trial, Testimony Of Herbert E. Schuette, Continued, May 6, 1975 [Doc. 148] ..... A-211(918)

Page

Volume IV

Transcript Of Trial, Deposition Testimony Of Anna M. McDonnell, May 6, 1975 [Doc. 148] ..... A-211(1022)

Transcript Of Trial, Testimony Of George H. Newman, May 6, 1975 [Doc. 148] ..... A-211(1056)

Transcript Of Trial, Testimony Of George H. Newman, Continued, May 7, 1975 [Doc. 148] ..... A-211(1090)

Transcript Of Trial, Testimony Of Richard Greves, May 7, 1975 [Doc. 148] ..... A-211(1186)

Transcript Of Trial, Testimony Of Robert A. Spies, May 7, 1975 [Doc. 148] ..... A-211(1217)

Transcript Of Trial, Testimony Of David L. Ratner, May 8, 1975 [Doc. 148] ..... A-211(1244)

Transcript Of Trial, Testimony Of Lee D. Arning, May 8, 1975 [Doc. 148] ..... A-211(1310)

Transcript Of Trial, Testimony Of Lee D. Arning, Continued, May 9, 1975 [Doc. 148] ..... A-211(1390)

Volume V

Transcript Of Trial, Testimony of H. Vernon Lee, Jr., May 9, 1975 [Doc. 148] ..... A-211(1431)

Transcript Of Trial, Argument Of Counsel, May 12, 1975 [Doc. 149] ..... A-211(1443)

Transcript Of Trial, Testimony Of Bruce M. Stargatt, May 13, 1975 [Doc. 149] ... A-211(1664)

Transcript Of Trial, Testimony Of Thomas Ford, May 13, 1975 [Doc. 149] ..... A-211(1696)

Transcript Of Trial, Testimony Of Richard Olney III, May 13, 1975 [Doc. 149] ..... A-211(1740)

Transcript Of Trial, Testimony Of Paul K. McDonald, May 13, 1975 [Doc. 149] ..... A-211(1793)

Page

Volume VI

Transcript Of Trial, Testimony Of Paul K. McDonald, Continued, May 14, 1975 [Doc. 149] ..... A-211(1827)

Transcript Of Trial, Deposition Testimony Of Fred J. Stock, May 14, 1975 [Doc. 149] ..... A-211(1853)

Transcript Of Trial, Testimony Of Robert M. Bishop, May 14, 1975 [Doc. 149] ..... A-211(1873)

Transcript Of Trial, Testimony Of Robert M. Bishop, Continued, May 15, 1975 [Doc. 149] ..... A-211(2016)

Volume VII

Transcript Of Trial, Testimony Of Robert M. Bishop, Continued, May 19, 1975 [Doc. 201] ..... A-211(2190)

Transcript Of Trial, Deposition Testimony Of Fred J. Stock, May 19, 1975 [Doc. 201] ..... A-211(2311)

Transcript Of Trial, Testimony Of Robert A. Spies, May 19, 1975 [Doc. 201] ..... A-211(2318)

Transcript Of Trial, Testimony Of James F. McDonnell, Jr., May 19, 1975 [Doc. 201] ..... A-211(2338)

Transcript Of Trial, Testimony Of Margaret Murphy, May 19, 1975 [Doc. 201] ..... A-211(2342)

Transcript Of Trial, Robing Room Conference, May 20, 1975 [Doc. 201] ..... A-211(2351)

Transcript Of Trial, Closing Statements Of Counsel, May 20, 1975 [Doc. 201] .... A-211(2379)

Transcript Of Trial, Robing Room Conference, May 21, 1975 [Doc. 201] ..... A-211(2519)

Transcript Of Trial, Closing Statements Of Counsel, Continued, May 21, 1975 [Doc. 201] ..... A-211(2531)

Page

Volume VIII

Transcript Of Trial, Charge Of The Court On The Issue Of Liability, May 21, 1975 [Doc. 201] ..... A-211(2596)

Transcript Of Trial, Robing Room Conference, May 22, 1975 [Doc. 201] ..... A-211(2638)

Transcript Of Trial, Charge Of The Court On The Issue Of Damages, May 22, 1975 [Doc. 201] ..... A-211(2715)

Opinion And Order Granting McDonnell & Co.'s Post Trial Motions, Dated December 5, 1975 [Doc. 105] A-213

Order Denying Plaintiffs' Post Trial Motions, Dated December 18, 1975 [Doc. 195] A-215

Order With Respect To Prejudgment Interest Dated April 22, 1976 [Doc. 106] A-217

Final Judgment Entered May 13, 1976 [Doc. 200] A-219

Page 29:

"Q Do you recall that the first time you put securities into the business of the firm that it was through a subordinated loan transaction?

"A I don't remember that.

"Q Do you recall how soon after your husband's death that this occasion occurred when you first put your securities in at the request of Murray?

"A I don't recall. I can't recall that year.

"Q Was it within a few years after your husband's death or many years after?

"A I don't know.

"Q Do you recall the amount?

"A No.

"Q Do you recall what was over a million dollars in market valuation?

"A It was not a million dollars.

"Q Mrs. McDonnell, let me show to you what is entitled 'New York Stock Exchange allied member or non-member application,' which is made out in your name and ask you to review it and tell me if it refreshes your recollection.

Then Mr. Dubin said "Are we marking this for identification?"

And Mr. Brooks said: "Let us see if it can be

identified.

"A That's my signature. I recall nothing else.

"Q Does this refresh your recollection as to whether the first time you put securities into McDonnell it was through a subordinated loan transaction?

"A Is that what that is?"

Then there was more talk between Mr. Dubin and Mr. Brooks wherein Mr. Dubin says:

"We don't know whether that's the first time Mrs. McDonnell put--" And Mr. Brooks says: That's what I am trying to get at."

And then he asked another question:

"This has checked on the first page, the box, subordinated lender and after, in parenthesis, I believe, the word 'account' written in --

"A Account?

"Q Account.

"-- which I think would mean you were subordinating securities in your account at McDonnell.

"A This I don't know."

MRS. LICHSTEIN: At this time I would like to introduce in evidence the application of Mrs. McDonnell to the exchange. It's been pre-marked as Exhibit II.

MR. BEEBE: We have no objection.

MRS. LICHSTEIN: Simultaneously, if I can manage it, I would like to introduce in evidence the 1962 subordination agreement signed by Mrs. McDonnell. It's been pre-marked as Exchange Exhibit JJ for identification.

(Defendant New York Stock Exchange Exhibit II received in evidence.)

MR. BEEBE: No objection to JJ.

(Defendant New York Stock Exchange Exhibit JJ received in evidence.)

MRS. LICHSTEIN: We are now going to page 35. Let me state before I read it we are going to talk about a paragraph, paragraph 8, which refers to the financial supplement of Mrs. McDonnell's application to the exchange as a non-allied member.

"Q Take a look at paragraph 8 again, Mrs. McDonnell, the 1.8 million figure, is that consistent with your recollection of the amount in market value of the securities?

"A I actually have no recollection.

"Q Would you have any reason to doubt that that would have been the amount of the market value?

"A No, I would have no reason to doubt."

MRS. LICHSTEIN: The next page we are going to read from is page 40. Some of this might be familiar to you because Mr. Beebe read a portion of this, but we

are going to continue and read a little bit further than Mr. Beebe did.

"Q Do you recall any explanation being given by Murray or anyone else as to why your money was being requested?

"A I think I mentioned earlier,expansion.

"Q Anything else?

"A No.

"Q Any particulars about expansion?

"A No.

"Q Were any problems of the firm mentioned?

"A I don't recall."

Page 43:

"Q My question is: was the need to secure New York Stock Exchange's approval of you as a subordinated lender a subject that anyone discussed with you at the time you signed the documents or about that time?

"A I don't know anything about it.

"Q You don't recall?

"A No.

"Q Do you recall whether you were aware of the need for New York Stock Exchange approval of you as a subordinated lender?

"A I don't recall that."

Page 43B.

"Q When you gave your securities to Murray in 1962 for the use of the business, did you understand that you would get any interest --

"A Yes.

"Q -- as a result of that?

"Do you recall how much you were to get?

"A No.

"Q Do you recall whether you were to continue receiving the dividends that were paid on the securities by the companies in which the securities were from?

"A I did."

Page 46.

The testimony that we are going to read from page 46 refers to a document already in evidence as Exchange Exhibit G.

"Q Mrs. McDonnell, I show you letter addressed to yourself from Murray McDonnell dated April 10, 1963, and ask you if you recall receiving that letter?

"A This is 1962?

"Q I believe it is dated 1963.

"A I recall receiving such letter-- some kind of a letter thanking me and telling me --

"Mr. Dubin: Do you recall specifically receiving

this letter?

"The Witness: This one letter?

"Mr. Dubin: Yes.

"The Witness: No, because I received--

"Mr. Dubin: So what Mrs. McDonnell is saying"--

And then Mr. Brooks continues:

"Q You recall receiving letters of this type starting at about this time?

"A Once or twice I received.

"Q And having reviewed it it is somewhat familiar to you?

"A All I remember in reviewing it is thanking me, period.

"Q Do you recognize Murray McDonnell's signature?

"A Yes."

I am next going to read from page 58:

"Q I show you another letter dated April 8, 1964, addressed to you and signed by Murray McDonnell and ask you if you recall receiving that.

"A I am sure I received a letter. I did receive the securities.

"Q Is that Murray's signature?

"A That is Murray's signature.

"Q Is this letter one of the type which you referred

to before as containing facts --

"A No. That isn't any thank you letter.

"Q Let me read the first paragraph:

'On behalf of all of here at McDonnell & Company, we thank you for your generous support.' And then Mr. Brooks says: "First mark this, please, as our next exhibit."

I would like to do the same thing. I would like to introduce as Exchange Exhibit KK a letter dated April 8, 1964, from McDonnell & Co. address to Mrs. James F. McDonnell, Sr.

MR. BEEBE: No objection.

(Defendant New York Stock Exchange Exhibit KK received in evidence.)

MRS. LICHSTEIN: We will continue reading where we left off.

"Q Mrs. McDonnell, this letter which has been marked Exhibit 6" -- which was in the deposition --

"A Isn't this the one I just looked at?

"Q Yes. That indicates that, along with the letter, various securities were returned to you?

"A That's right.

"Q Does that letter refresh your recollection as to an agreement by McDonnell & Company, Incorporated,

to provide scheduled return of the securities that you pledged with them?

"A I presume this was it. I did return those securities.

"Q I show you a letter,. the same type of letter"--

"A You see, I know these letters. This probably came. That's all I can say. I could recognize the letter and that's all I can tell you."

MRS. LICHSTEIN: Now I am going to read from page 60.

"Mr. Brooks: Let us mark this letter as the next exhibit."

Then there is some colloquy between Mr. Dubin and Mr. Brooks, the upshot of which was a letter dated August 5, 1964 from McDonnell to Mrs. James F. McDonnell, was marked New York Stock Exchange Exhibit 7 for identification, and I would like to mark that August 5, 1964, letter from Murray McDonnell to Mrs. McDonnell as Exchange Exhibit L, and offer it into evidence.

(Exchange Exhibit LL received in evidence.)

MRS. LICHSTEIN: We are now going to page 62.

"Q I show you another letter which is of a similar nature to the last two and ask you if you recall receiving that?

"A He is returning securities again.

"Q Is that Murray's signature?

"A Yes.

"Q On this April 8, 1965, letter, do you have a recollection of receiving this letter?

"A No."

MR. BEEBE: Excuse me, I believe it is February 8th.

MRS. LICHSTEIN: You are absolutely right. It states February 8, 1965.

"Q Do you have a recollection of receiving this letter?

"A No. The securities are there so I must have."

I would like to offer into evidence the February 8, 1965, letter from T. Murray McDonnell to Mrs. McDonnell. It's been pre-marked as Exchange Exhibit MM for identification.

MR. BEEBE: No objection.

(Defendant New York Stock Exchange Exhibit MM received in evidence.)

Q Continuing on the same page.

"Q mrs. McDonnell, I show you a letter dated August 2, 1965, from Murray McDonnell to yourself and I would like you to read it and tell me if you recall receiving it?

"A I know the signature and that's all.

"Q Are any of the contents of the letter familiar to you?

"A Yes. I guess they are."

Mr. Brooks said "Let us mark this as the next exhibit in evidence in order."

I guess it comes as no surprise I also want to mark it as the next exhibit in order, and I offer the August 2, 1965, letter from T. Murray McDonnell to Mrs. James F. McDonnell, Sr. as Exchange Exhibit NN for identification.

MR. BEEBE: I guess it comes as no surprise that I have no objection.

(Defendant New York Stock Exchange Exhibit NN received in evidence.)

"Q The first paragraph of the letter, again, thanks you for your support during the past three years and the last sentence of it reads 'Without the'-- and by that I think it means your support -- 'we couldn't have maintained our firm as it is today.'

"Do you recall having been told that in words or substance by Murray during those three years?

"A No. I would just take that as flattery.

"Q The second paragraph says that 'You will remember

that at my request you deposited securities in a subordinated account in McDonnell & Company in June, 1962, which had a market value, at that time, of approximately $1,825,000.

"Does that language refresh your recollection as to the type of transaction that you made your investment in McDonnell through?

"A Say that again. I don't understand that.

"Q Does a reference in that sentence to a subordinated account refresh your recollection as to how you made your contribution to the capital of McDonnell?

"A I spoke before how I made my investment. I subordinated my account.

"Q Does the amount of $1,825,000 refresh your recollection?"

Then Mr. Dubin says "Do you recall.

"A No.

"Q The third paragraph states in substance that the firm has already transferred securities to you having a market value of $1,700,000 and that as of August 1st of that year, 1965, the firm continued to hold in your subordinated account approximately $900,000 in market value of securities.

"Do you recall whether the amount in your account increased through the appreciation of the securities --

"A I do not.

"Q -- during the period?

"A I can't answer that.

"Q Do you recall, subsequent to your initial deposit of the securities in" -- and the transcript reads "1965," but I think Mr. Beebe will agree it should be 1962.

MR. BEEBE: Yes.

MRS. LICHSTEIN: (Reading)

"Q -- whether you deposited any additional securities after that initial deposit?

"A No, I did not.

"Q So that if, in 1965, the account was worth 2,600,000 it would have been only through growth that that that could have occurred?

"A It would have to be. I didn't give them anything else."

Page 66.

"Q Do you recall signing more than one subordination agreement?

"A No. I can't recall that truthfully.

"Q Let me show you a document entitled 'subordination agreement,' and ask you --

"A 1966. I can't recall any of this. These are my

signatures.

"Q Your signature, I believe, appears in at least three places?

"A That's right.

"Q And possibly four?"

Then Mr. Dubin says "Do you want her to verify each page?

"Mr. Brooks: I just want her to tell me that is her understanding--

"A It is my signature."

Then Mr. Dubin pops in again --

MR. BEEBE: Objection.

MRS. LICHSTEIN: (Reading)

"There are two signatures on this document which Mrs. McDonnell verifies as being her signature."

And Mr. Brooks says: "I think there are three.

"The Witness; Yes, I think there are three.

"Mr. Brooks: Let us mark this and it is a group of documents.

"The first three pages are entitled 'Agreement subordinating individuals account.'

"The next document is a letter dated June 18, 1965, to the Division of Finance of the Department of Member Firms of the New York Stock Exchange signed by T. Murray

McDonnell.

"The next document is a one page letter dated June 18, 1965, addressed to T. Murray McDonnell by Mrs. McDonnell signed 'Anna M. McDonnell, lender' and acknowledged or accepted by T. Murray. McDonnell.

"The next document is a one page letter dated June 18, 1965, to McDonnell & Co., Incorporated, signed 'Anna M. McDonnell' to which is attached a schedule of securities.

Your Honor, at this time I would like to introduce into evidence that group of documents which have been pre-marked as Exchange Exhibit 00 for identification.

MR. BEEBE: No objection.

(Defendant New York Stock Exchange Exhibit 00 received in evidence.)

MS. LICHSTEIN: Now we are going to page 70:

"Q Mrs. McDonnell, I show you a letter dated August 24, 1965, addressed to yourself and signed by Murray McDonnell and ask you if you recall receiving that letter.

"A I don't recall.

"Q Is that Murray's signature?

"A Yes, it is.

"Mr. Brooks: Can we mark that letter dated August 24, 1965."

MS. LICHSTEIN: At this time I would like to introduce into evidence the letter dated August 24, 1965, from T. Murray McDonnell to Mrs. Anna Murray McDonnell. It's been pre-marked as Exhibit Exhibit PP for identification.

MR. BEEBE: No objection.

(Defendant New York Stock Exchange Exhibit PP was received in evidence)

MS. LICHSTEIN: The next testimony was referring to that letter which has just come in evidence in this case:

"Q Mrs. McDonnell, do you have any knowledge as to why McDonnell & Company was continuing to return

securities to you while, at the same time, receiving from you another subordination agreement --

"A No.

"Q -- with schedule of securities attached?

"Do you have any recollection as to the market value of these securities on the date that you executed the subordination agreements?

"A I haven't any idea."

Turning to page 72:

"Q The next letter is of the same type, Mrs. McDonnell, except, at this time, it appears to have been signed by you, and I ask you whether that is your signature?

"A It is. Yes.

"Q Do you recall receiving that letter?

"A No. Tom McKay was dead.

"Q Did you know Tom McKay?

"A He was a friend.

"Q Did you have any conversations with Tom McKay about your subordinated account?

"A No. I met himin Rome. That's the only time I saw him. We didn't talk business.

"Q Was Murray the only employee or officer of McDonnell & Company with whom you spoke about your

mdr3 "Anna M. McDonnell

subordinated account?

"A No. I spoke to Shawn, maybe.

"Q Morgan perhaps?

"A No.

"Q Charles?

"A No.

"Q Just Shawn or Murray?

"A Yes.

"Q And Murray?

"A Yes."

At this time I would like to offer into evidence as Exhibit Exhibit QQ for identification the November 13, 1968 letter from Tom McKay to Mrs. Anna McDonnell.

MR. BEEBE: No objection.

(Defendant New York Stock Exchange Exhibit QQ was received in evidence)

MS. LICHSTEIN: Page 75:

"Q Now, the agreement subordinating your account which has been marked --"

Mr. Dubin said:

-- "Which agreement?"

Mr. Brooks continued:

"Q Exhibit 10. We only have one such agreement

in the exhibits. That is Exhibit 10.

"That agreement provides that it would expire on June 30, 1966 as you noted on the first page.

"Do you recall that agreement ever being renewed?

"A No. I don't recall that.

"Q Because apparently by 1968 you still have the same securities in your account?

"A I don't recall.

"Q Do you have any recollection?

"A I have no recollection at all."

Page 78:

"Q When you took the securities from your safe deposit box to deposit in McDonnell in 1962, was that the entire portfolio that was in the box?

"A This is 1962. That isn't entire."

MS. LICHSTEIN: Page 90: This testimony we are going to read refers to Exchange Exhibit I in this case. Let us mark the January 30, 1969 letter.

"Q Mrs. McDonnell, would it be that you are the mother to whom the letter is addressed? Can you tell that from the context? ...

"A I presume I am.

"Q Will you presume it was written by your

mdr5 "Anna M. McDonnell

son James?

"A I wouldn't have any idea. No, I don't know who wrote that letter.

"Q But it would be one of your children?

"A Well, he calls me 'Dear Mother.' He must be a child.

"Q Mrs. McDonnell, when Mary requested" --

MR. BEEBE: Objection. This has been read. The following passages have been read already on direct.

MR. LICHSTEIN: Your Honor, I believe that we are reading it prefaced with a different portion of the testimony than that Mr. Beebe hadn't read and are putting it in what we believe to be the proper context.

MR. BEEBE: I believe it having once been read on direct it's not subject to re-reading on cross.

THE COURT: If it makes more sense to take the thing as a coherent whole, and it doesn't take an inordinate amount of time I don't see any reason not to do it.

MS. LICHSTEIN: I believe it involves six lines, your Honor.

THE COURT: Then let's go on.

MR. BEEBE: I will withdraw my objection, if that's all.

THE COURT: Go ahead.

MS. LICHSTEIN: (Reading)

"Q But it would be one of your children?

"A Well, he calls me 'Dear Mother." He must be a child.

"Q Mrs. McDonnell, when Murray requested the additional deposit of $800,000 -- or whatever the amount was -- did you hesitate at all in complying?

"A No.

"Q Would that have been your usual practice had it not been Murray calling?

"A Any child had what they wanted if I could give it to them, help them out."

Page 96:

"Q So far as you know you were aware of no change in the condition of the firm in 1969 from 1965 or 1962, is that correct?

"A No, it's not correct.

"Q Tell me what you knew.

"A Because I knew things were worse in 1969 or I wouldn't have been asked for more money.

"Q Did you assume thatthe request to you for more

mdr7 "Anna M. McDonnell

money indicated that conditions worsened?

"A Yes. They needed it. Yes.

"Q Did you assume in 1962 that this request to you for your personal capital indicated that conditions were not as good as they once had been in McDonnell & Company?

"A In 1962?

"Q In 1962.

"A No.

"Q How about 1965?

"A I really don't recall that. I don't recall doing it in 1965.

"Q But you testified that was your assumption in 1969?

"A 1969 they requested it because they needed it.

"Q Did you conclude that the reason why they needed additional capital was that conditions had worsened at the firm?

"A Yes, I did.

"Q Did you have any specific knowledge about what conditions had worsened and to what degree?

"A No.

"Q Did Murray give you any information in respect to worsening conditions at the firm?

"A I don't recall what he told me.

"Q Is it possible that he did tell you " --

Then Mr. Dubin made an objection to the question, and then another question was asked:

"Q Can you tell us that he did not give you such information about conditions worsening?

"A I can't say that."

Page 100:

"Q Mrs. McDonnell, did you have any knowledge of the conditions of the back office operation in McDonnell in January 1969?

"A I don't know.

"Q You don't know?

"A No.

"Q Mrs. McDonnell, the last four topics that I have asked you questions about, can you tell me that Murray McDonnell did not give you information about those topics? "

Then Mr. Dubin says: "What topics, please?"

Mr. Brooks goes on --

"Q The topic of whether McDonnell had been operating profitably or not at that time, the topic of what its capital position was, and whether it was in violation of exchange rules in respect to capital, the

mdr9 "Anna M. McDonnell

topic of its back office operations. I guess it's only three.

"Can you tell me did Murray McDonnell did not in January of 1969, when he asked you to put in the additional securities, tell you about those conditions?

"A I don't recall. May I say one thing here? Why is it Murray McDonnell when it was Morgan McDonnell?

"Q You told me that the only person you spoke with was Murray.

"A You are right.

"Q I assume Morgan couldn't have told you anything if you did not have a conversation with him. I assume Morgan didn't tell you anything?

"A That's right.

"Q If anybody told you anything it would have to be Murray. Can you tell me that Murray did not tell you?

"A I couldn'tsay that he did not. I don't recollect.

"Q At this time was Morgan active in the firm's affairs?

"A I don't know when Morgan joined the firm .

"Q There was a time when Morgan was connected with the firm in some capacity, was he not?

"A Yes, he was connected, but I just don't remember the years because he was in Chicago.

"Q Was he also in New York at some time?

"A Yes. He was at one time in New York.

"Q When was he in New York?

"A When, I don't know.

"Q Would you see him from time to time?

"A Morgan?

"Q Yes.

"A He would live with me when he was in New York."

Page 109:

"Q Mrs. McDonnell, over what period of time did you know Mr. Olney?

"A I can't answer that. I don't know.

"Q Was it for a number of years?

'A For many years. Probably as long as he was with them."

On page 113, the testimony that we are going to read refers to some portions on a series of account statements received by Mrs. McDonnell from McDonnell & Company, referring to one of her accounts there.

At this time I would like to offer into evidence the group of account statements which have been

pre-marked as Exhibit Exhibit RR for identification.

MR. BEEBE: I don't see the relevance, but I am not going to make anobjection. No objection.

THE COURT: New York Stock Exchange Exhibit RR received in evidence.

(Defendant New York Stock Exchange Exhibit RR was received in evidence)

"Q Mrs. McDonnell, on the statement for the period ending August 28, 1969, there is a debit entry -- it appears to be a debit entry -- for flowers sent to Mrs. Genevieve McDonnell Bissell. Does that have any meaning to you?

"A She is my daughter.

"Q Would it have been likely that you had directed that flowers be sent to her?

"A Probably.

"Q Why is it that the charge for those flowers would appear in a statement from McDonnell & Company to you?"

MR. BEEBE: Excuse me, I am going to object to this. I just see no relevance to this question about flowers.

THE COURT: Overruled.

MS. LICHSTEIN: I will repeat the question.

"Q Whi is it that the charge for those flowers would appear in a statement from McDonnell & Company to you?

"A The only possibility -- I might have telephoned and asked them to do something from out of town, Massachusetts, to send it on for me.

"Q As a convenience for you?

"A That's it. "

Page 115, still referring to the same group of account statements:

"Q On the statement for the period ending July 31, 1969, there is an entry, for second quarter unemployment tax, household employees, I assume."

MR. BEEBE: Excuse me --

MS. LICHSTEIN: Are you with me?

MR. BEEBE: Yes, I lost the place.

MS. LICHSTEIN: But you found it now?

MR. BEEBE: Yes.

MS. LICHSTEIN: (Reading)

"Q Can you tell me what that entry would mean?

"A It might be I asked somebody down there to pay it. I couldn't figure out the unemployment tax.

"Q On your household staff?

"A Yes.

rdh 1 "Anna M. McDonnell

"Q The next entry is one bottle of French champagne.

"A Sent to somebody on a boat."

Page 121:

This testimony is referring to Plaintiffs Exhibit 4, which has been offered in evidence in this case.

"Q I show you a copy of a letter that appears to be dated September 30, 1969, addressed to Mr. Robert M. Bishop, vice president for the New York Stock Exchange and signed by stockholders and subordinated account holders. The copy I have is not too good. Mr. Dubin has a better copy. It may help us to see that but in lieu of that let me show you this and ask you if you recall seeing that letter or its original before. One of the signature lines is for your signature.

"Mr. Dubin: It says by someone else. By T.M.

"A Then Murray must have signed it.

"Q T. Murray McDonnell.

"A T.M. McDonnell.

"Mr. Dubin: That is not your signature?

"The Witness: Not my signature.

"Mr. Brooks; I think you made that clear.

"Mr. Dubin: I have difficulty in reading it.

"Mr. Brooks: You wouldn't have a better copy of this?

"Mr. Dubin: I might but it would take us an amount of time to get through.

"Q Do you recall ever having seen such a letter before?

"A I don't recall.

"Q Do you recall authorizing Murray McDonnell to sign your name followed by his initials?

"A I am sure I did.

"Q At the time you did authorize him did he make any explanation to you about the transaction which is reflected--

"A I don't recall.

"Q Is it likely that he did?

"A He wouldn't ask me to sign something if he hadn't told me what it was all about, I presume."

Page 144.

"Q Mrs. McDonnell, did there ever come a time when you learned that McDonnell & Company was going to be liquidated?

"A There did come such a time.

"Q After that time came did you ever make a complaint to any officer or employee or former officer or employee of McDonnell about what you had been told regarding the state of McDonnell at the time you made those various subordinations that we were discussing?

rdh3 "Anna M. McDonnell

"A No, sir, never.

"Q Did you ever make a complaint to anyone?

"A No."

Page 146.

"Q After you learned that McDonnell was going to be liquidated did you ever ask Murray McDonnell why he had not provided you with any information?

"A No.

"Q Did you ever ask any other officer or employee or former officer or employee of McDonnell that question?

"A No."

Page 153.

" This testimony again refers to an exhibit in this case and the exhibit that it refers to is Plaintiffs' Exhibit 11A.

"Q Mrs. McDonnell, Exhibit 2 to Exhibit 28 is a Series B debenture referred to. Was a demand ever made upon McDonnell & Company prior to its liquidation for payment of that debenture?

"A I don't know.

"Q Can you tell me as a certain matter that you never made such a demand?

"A No.

"Q Do you mean by that that you can't tell me that you

never made such a demand?

"A I never made a demand. I never made any demand. I never made. Any demand that was made was made by Jim."

Page 156.

"Q Did Murray ever advise you that he was attempting to effect a substitution of the E for the B?

"A This I don't recollect.

"Q At this time?

"A I don't recollect.

"Q Can you say that it was never told to you?

"A I couldn't say that. I said I don't recollect."

Page 160.

"Q Mrs. McDonnell, did you ever request the New York Stock Exchange to assist the trustees in obtaining payment on the Series B debenture from McDonnell & Co., Incorporated?

"Mr. Dubin: Are you asking Mrs. McDonnell?

"Mr. Brooks: Yes.

"A I personally?

"Q Yes, or as trustee.

"A No.

"Q Thank you.

"A No.

"Q Do you know whether such a request for assistance

rdh5 "Anna M. McDonnell

was made by any co-trustee?

"A I don't know. I can't answer that.

"Q Did you ever advise the New York Stock Exchange as to the status of the Series B debenture?

"A No.

"Q Did you ever have any communication with anybody at the Stock Exchange about it?

"A No."

MRS. LICHSTEIN: At this time we are going to read from the interrogatories. The first interrogatory that we are going to read--

MR. BEEBE: Excuse me. I would like to reserve my right because I know there will be some redirect because of the particular areas that were selected in the cross.

THE COURT: You may do so.

MRS. LICHSTEIN: The interrogatory set that we will be reading from is the supplemental response of Anna M. McDonnell to first set of Rule 33 interrogatories propounded by defendant New York Stock Exchange.

The first interrogatory that we are going to read is number 42.

THE COURT: Have we at any time told the jury what interrogatories are so they will know?

MR. BEEBE: No, I don't think so.

rdh6

THE COURT: Ladies and gentlemen, these are questions that are propounded by one party of this lawsuit to another party to be answered by that party under oath. This is under pre-trial fact finding part of the case. These are questions called interrogatories put to Mrs. Anna McDonnell and her responses are given under oath and they are written down.

These questions and answers in written form are being read to you at this time.

MRS. LICHSTEIN:: Interrogatory number 42:

"Identify, A, the inducements and/or promises, and B, the dates on which they were made which led you to enter into the subordination agreement or make the additional deposits referred to in your answer to interrogatory number 1.

"Response: A and B, in 1962, 1965 and 1969 I was asked by my son, T. Murray McDonnell, to either subordinate my account at McDonnell or to introduce my amount of the contribution to an already existing subordinated account at McDonnell. As T. Murray McDonnell is my son I agreed to subordinate my account at McDonnell in 1962 and 1965 and as was the case in 1969, to contribute to my already subordinated account.

"Interrogatory number 43: Identify the person

or persons who made such inducements and/or promises as are identified in answer to the preceding interrogatory.

"Response: T. Murray McDonnell. Whoever, there were no inducements or promises made by T. Murray McDonnell but solely a request to subordinate my account or to make an additional contribution to my already subordinated account to which I agreed."

This is referring to the claim of Mr. McDonnell and Mrs. McDonnell of the Series B debenture.

"Interrogatory number 52: Were such votes by you as trustees of the trust estate of James McDonnell indicated orally or in writing? If in writing, identify all such writing?

"Response: It is my present belief that when my vote was solicited for any matter pertaining to the trustee's estate of James F. McDonnell, Sr., I would give my vote orally. In addition I believe that James F. McDonnell, Jr., on many occasions would prepare a writing memorializing the actions taken by my co-trustees. James F. McDonnell, Jr. or T. Murray McDonnell would be in possession of such writings. I have none of the aforementioned writings in my possession."

"Interrogatory number 53: On what date and how were you made aware that the conversion of the Series B

debenture of the trust estate of James F. McDonnell into the Series E. debenture had taken place?

"Response: In approximately late June or early July, 1969, James McDonnell, Junior, informed me that the Series B debenture had been illegally converted into a Series E debenture.

Interrogatory No. 56: Prior to March 1, 1970, did you ever communicate with the exchange in respect to payment of the Series B debenture or conversion of the Series B debenture into the Series E debenture?

"Response: No.

"Interrogatory 64: Did you at any time through written or oral communications notify, A, the Securities and Exchange Commission, and/or B, the exchange and/or C, the American Stock Exchange of any of the matters of which you complain in this action?

"Response: No."

MR. BEEBE: I may have some other responses to the interrogatories at some points but I would like a chance to study them before reading them in at this particular moment.

Is that all right?

THE COURT: I take it argument on the question of their admissibility will await the event.

rdh8a

MR. BROOKS: Yes.

THE COURT: We will take our recess now.

rdrl

(In open court; jury present)

MR. BEEBE: I call George H. Newman.

G E O R G E H. N E W M A N, called as a witness by the plaintiffs, being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BEEBE:

Q Mr. Newman, what do you do now?

A I do nothing at the moment.

Q You are unemployed?

A That is correct.

Q Were you with the New York Stock Exchange in 1968, 1969?

A Yes, I was.

Q Were you involved during that period as a coordinator with McDonnell Company as one of the firms under your supervision?

A Not in '68. Starting in April of '69 I was a coordinator.

Q Could you briefly describe to the jury your educational background, sir?

A I attended the New York Institute of Finance.

Q What year did you --

A It was a continuing educational course, beginning about 1936 right through to 1958 or 1960.

Q And had you been with the New York Stock Exchange for many years prior to 1968, 1969?

A I started with the New York Stock Exchange in May of 1936.

Q What did you start as?

A As a messenger.

Q Could you describe for the jury your career, briefly, the highlights at the New York Stock Exchange thereafter?

A. I became a clerk shortly thereafter and about 1955 -- I beg your pardon. I left the exchange in June of '42. I went with the U. S. Air Force. I returned in October of 1945. I was reemployed in a clerical capacity.

I became assistant manager of the division of finance I believe it was 1955.

Shortly thereafter I became manager of the division of finance. I continued in that position until I became a coordinator in 1969.

Q Could you describe your responsibilities as a coordinator starting in, I think you said, April 1969?

BEST COPY AVAILABLE

A I think my responsibility encompassed some 105 or 110 member firms of the New York Stock Exchange.

Q Did they have any particular letters in the alphabet?

A The firms are broken down alphabetically, and my group of firms were the M, N, O and P group.

Q What was the responsibility you had with regard to compliance of the member firms with the New York Stock Exchange rules?

A Within the department of member firms we only had certain rules that we had jurisdiction over. Therefore, we didn't have compliance with all the rules of the exchange in that department.

Q Could you explain to the jury which ones were under your responsibility?

A Well, briefly the rules covering capital requirements, subordinated borrowings, personal borrowings.

Q When you say capital requirements, I think the jury is somewhat familiar with net capital. Is that what you are referring to?

A That is correct.

Q Did exchange examiners report to you as part of the setup?

A No.

Q Who reported to you as coordinator?

A My staff, the exchange examiners were not a part of my staff.

Q What classification did your staff fall into?

A Well, as a coordinator I believe I had three assistants.

Q Did you have anything to do with reviewing the operational questionnaires and the financial questionnaires submitted by the firms?

A The operational questionnaires did come to me for review, yes. Financial questionnaires went to the examiners' division.

Q And what was your responsibility when you found a violation of the exchange rules?

A I beg your pardon?

Q What was your responsibility when you found a violation of the exchange rules in the course of your review?

A I would prepare a memorandum for the consideration of the department head.

Q Was it your responsibility to gather and present the facts accurately for the department head?

A Gather and present the facts, yes.

Q You weren't backing away from the word "accurate," were you? I mean, accuracy was a part of that, was it not?

A The facts were submitted. I don't know whether accurately or not.

Q The facts you received though?

A That is correct.

Q Approximately how many firms were members of the New York Stock Exchange in 1967, 1968?

A 1967 and '68, I would say in excess of 500.

Q If I told you that you had said approximately 650 at your deposition, would that be consistent?

A It's in excess of 500.

Q Of those 650, approximately how many were in violation of rule 325 during the period 1967 to 1970?

MR. BROOKS: I don't think there has been any foundation laid for Mr. Newman's having knowledge of the activities of all the firms on the stock exchange during those years.

Q Can you answer the question, sir?

THE COURT: Can you tell us today?

THE WITNESS: No, I couldn't tell. I would

have to guess and that would be not what I would want to do.

Q Have you been told not to guess?

THE COURT: I'll tell him not to guess if there is any question about it.

Q I don't want you to guess either. If I could refer to page 32 of your deposition you were asked this question. I believe this was taken a few years ago. May 3, 1973. Do you recall?

A That's two years.

Q Was your recollection better at that point perhaps?

A It could very well be.

Q This is on page 32:

"Q Of those approximately 650 firms during the period 1967 through 1970 could you approximate how many of those firms in 1967 or '68 or '69 or '70 were in violation of rule 325?

"A What years?

"Q Start with 1967.

"A Approximately 10.

"Q 1968?

"A No, no, I'm taking the entire --

"Q Entire four-year period?

"A That's right."

Was that accurate when you gave it?

A I would say it was, yes. I kept a record of those things. I don't have the record.

Q You left the record at the New York Stock Exchange when you left?

A I beg your pardon?

Q Did you leave the record at the New York Stock Exchange when you left?

A Yes, I did.

Q What was the form of the record?

A I had a card record of each firm and I also had what I call a master sheet briefly reciting the facts. The card had a little more detail than the master sheet. It was for my own information or so-called ready convenience, if I wanted to see what happened before in previous years.

Q Was one of the cards McDonnell & Company?

A I would think not because at that time -- I did this when I was manager of the division of finance. No, it wouldn't be.

Q Were similar records kept when you became a coordinator by yourself?

A No, not by me.

Q When you took over from Mr. Schuette, which I believe you did as coordinator; is that right?

A Yes.

Q When you took over did you review what we call the SOQ file and other files regarding McDonnell & Company?

A Yes, I did.

Q Could you remind the jury what the SOQ file was?

A Well, the SOQ file was a special operations questionnaire file.

Q What was the condition of McDonnell & Company when you found it there in March 1969 as to its capital position?

A I don't recall its capital position at that time.

Q Again reading from your deposition, sir, page 126. It's in the second volume.

"Q Were you aware that McDonnell & Company's capital position was precarious in approximately March of 1969?

"A Yes."

Was that accurate?

A March of '69?

Q That's just when you were coming on board, I believe.

A That would have to be approximately the time that I was first informed. Yes, I would say that was accurate, yes.

Q What was Mr. Stock's function at that time?

A I think he was the assistant director immediately in charge of the coordinator's group.

Q I handed to you a copy of a routing slip.

A Yes.

MR. BEEBE: I'm offering that in evidence. I believe there is no objection.

MR. BROOKS: That depends on whether Mr. Newman identifies the signature.

Q That was your signature, wasn't it? I thought we cleared that up.

A Yes, it's my signature.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 23B is received in evidence)

Q Did you receive the attached memorandum from Andy McElroy?

A If it's addressed to me. I don't recall receiving it at this late date.

Q Did you take the attached memorandum and attach it to the routing slip and send it on with the notations on there to Mr. Stock?

A Yes, I did.

Q Now, Mr. McElroy and Mr. Schuette have testified about a meeting on April 2, 1969 with the exchange staff and people from McDonnell & Company.

Do you recall that meeting?

A No, I don't at this time.

Q There is mention in the document that's been marked, a memorandum of that. Maybe I should show you Exhibit 23. I want you to tell us, if you will, who was on the committee.

A I don't know.

Q Do you know what the committee was?

A No, I don't. This, incidentally, is not my memorandum.

Q I appreciate that. The last sentence of it reads, "A subsequent meeting held by Mr. Stock, Huntoon, Newman, Zaremba, McElroy and Schuette explored possible restrictions to be recommended to the committee."

Does that remind you at all of such a meeting and who the --

A Not at this time, no, sir.

Q Sir, do you remember, as you were becoming coordinator in charge of McDonnell, among other companies, telephone callswhich you had starting late in April with Murray McDonnell concerning the firm's capital position?

A I don't recall any specific telephone calls with Murray McDonnell.

MR. BEEBE: I offer Exhibit 54 for identification in evidence. I believe there is no objection.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 54 was received in evidence)

MR. BROOKS: We are conducting a check to ascertain whether the handwritten material was on the exhibit.

(Pause)

MR. BROOKS: My copy does not contain any handwriting, your Honor. I object tothe handwriting. I will be glad to supply a clean copy.

THE COURT: Why don't you do that.

MR. BEEBE: In fact, yours without the handwriting is almost as illegible as mine. Why don't we substitute a retyped version which I happen to have here. Would that be all right?

MR. BROOKS: Perfectly agreeable.

(Pause)

MR. BROOKS: I do have a problem. It's different starting with the date. The date on the first offer is April 21 and the first offer is April 22.

MR. BEEBE: Maybe I have given you a retype of the next exhibit. I will have to withdraw that and go back to yours.

Q Have you seen a copy of that memorandum recently, sir?

A May I read it?

Q Yes.

(Witness reads)

A Ask your question, sir.

Q The last question was, have you seen that memo recently, and I mean before today.

A I don't recall recently. It would have to have been years ago.

MR. BEEBE: Iwould like to read the first three paragraphs.

(First three paragraphs of Plaintiffs' Exhibit 54 in evidence was read to the jury)

Q Mr. Newman, which of the above information was reported to Mr. Stock?

A All of it, I would suppose.

Q Do you recall at this time speaking on the phone -- by "this" I mean late in April 1969. I'll change that a little bit, in April 1969, talking to Mr. McKay at the McDonnell firm?

A Do I remember talking to him at this date? No, I don't remember talking to him.

Q Late in April. Do you remember that?

A I don't remember at this date. It certainly indicates that I did talk to him.

Q I don't mean to confuse you, sir. I am not limiting it to the particular document just marked in. I am saying in any respect do you remember having conversations with Mr. McKay about McDonnell's capital?

A I had conversations with Mr. McKay from time to time, yes.

Q Do you recall a conversation with Mr. McKay in which he told you that Mr. McDonnell failed to appreciate the urgency of the need for capital? It's not in thatmemo.

A I recall that, yes.

Q And --

A I think there was a lack of communication between Mr. McKay and Mr. McDonnell for some reason.

That's why on three attempts I finally was successful in reaching Mr. T. Murray McDonnell. He was not always available.

Q I show you a memorandum which has been marked at the depositions, and this is the one that I have a retyped version for. It's dated April 22, at the bottom April 23. We can mark that the next exhibit, A and B, for identification.

I will offer those in evidence, both of them.

MR. BROOKS: No objection.

(Plaintiffs' Exhibits 54A and 54B were received in evidence)

(Third paragraph of Plaintiffs' Exhibit 54A was read to the jury)

Q Did you bring -- did you have discussions with the Securities and Exchange Commission or representatives of the SEC in late April 1969?

A I don't recall that date. I do recall talking to the SEC.

Q In or around that period?

A In or around that period.

Q Would the name Joe Barton ring a bell?

A The name Joe Barton is familiar, yes.

Q What was your purpose in talking to him?

A I don't recall. I remember Herb Schuette, when he left and I took over, telling me to keep in touch with Barton at the SEC. What our conversation was about other than that I don't recall at this moment.

Q I hand you Exhibit 55 marked for identification. Does that refresh your recollection?

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 55 was received in evidence)

Q Does this memorandum refer to one of the calls you had with Mr. Barton at the SEC on April 28, 1969?

A Yes, sir.

Q Did you tell Mr. Barton -- let me just read from the third paragraph.

You called Mr. Barton with the information in hand that you had received from Mr. McDonnell about borrowing some subordinated or raising some subordinated money.

"I called Mr. Barton, who seemed particularly interested in knowing whether there was a books and records problem. I told Mr. Barton that the firm was experiencing some difficulty in this area, apparently due to its conversion from NCR to IBM. I also told Mr.

Barton in response to his inquiry that the exchange was receiving estimated capital positions from the firm and the latest one on hand was as of April 14 which showed a ratio of 1983 per cent. Mr. Barton mentioned that the exchange was concerned when a firm exceeded 1500 per cent ratio, and I said it was and then told him of Mr. Murray McDonnell's plan to subordinate $1 million today."

Does this memorandum represent everything you told Mr. Barton in that conversation?

A I don't recall.

Q Do you know of anything that's outside of this that you told him?

A I don't remember at this time.

MR. BROOKS: Your Honor, I think the question is misleading. Mr. Beebe has read only a portion of the memorandum. There is more to it. If the question really means does the whole memorandum encompass the conversation, I think it's a proper question.

MR. BEEBE: Of course it did.

MR. BROOKS: With that explanation I will sit down.

Q Did you tell Mr. Barton when he inquired about what was the condition of McDonnell & Company,

that there was a serious capital problem?

A Would you repeat that question, please? I lost part of it.

(Question read)

A I don't know that I mentioned a serious capital problem.

Q In fact you mentioned to him that the latest ratio on April 14th from the firm showed 1987 per cent, which is still below 2000 per cent: is that right?

A That is correct.

Q You didn't mention to him, according to this memo anyhow, the computations that Mr. McElroy had forwarded toyou, which has been marked as the first exhibit this afternoon, showing computations the ratio of 2229 per cent and others all over the 2000 ratio; is that right?

MR. BROOKS: I object, your Honor. That exhibit has dates attached to those ratios and no date is as late as the date that we are inquiring of now.

Q Sir, did you mention to Mr. Barton that the latest computations that the exchange had made showed ratios far in excess of the 2000 limit?

A I don't recall that, no, sir.

Q Did you mention to Mr. Barton of the SEC when he called inquiring aboutthe problems at McDonnell the $7000 a month loss through March of '69 that was the subject of your memorandum of April 22?

A I don't recall that.

Q Did you mention to him that Mr. McKay -- anything about what Mr. McKay told you about Mr. McDonnell about not appreciating the need for more capital immediately?

A What I told Mr. Barton is in this memorandum. I don't remember anything more than that.

Q Is there any reason why you didn't tell him these other things when he asked about the condition of McDonnell & Company?

A No, I don't know. I don't know that he asked about capital position of McDonnell & Company.

Q Well, the document will speak for itself on that. He asked what is reflected in this document; is that correct?

A Sir?

Q He asked what is reflected in this document: is that correct?

A That is correct.

Q Up in the righthand corner there is a

handwritten note addressed to Hank. Is that Mr. Fred Stock's --

A His initials are on the bottom of it.

Q I believe it reads, "Keep somewhat in touch with Barton" -- can I follow your copy, sir?

"Keep somewhat in touch with Barton so we know if they send a man into the firm."

What did you understand the purpose of Mr. Stock's instruction to be?

MR. BROOKS: I object to the question about Mr. Stock's purpose.

MR. BEEBE: What his understanding was, that's what I am asking.

THE COURT: How is he in a position to interpret Mr. Stock's state of mind?

MR. BEEBE: I was asking -- maybe I should rephrase that, sir.

Q What did you do in response to what Mr. Stock instructed you?

A I don't recall.

Q Did you keep tabs on Mr. Barton thereafter?

A Did I keep tabs on Mr. Barton?

Q Yes, in response to that note.

A No.

Q Did you keep in touch with Mr. Barton?

A I don't recall that I did, no, sir.

Q Do you know if the exchange was cooperating at this point with the SEC with regard to McDonnell & Company?

A This would indicate that there was cooperation with the SEC.

Q I believe this would indicate, coupled with your testimony, what happened, yes.

A I beg your pardon?

Q It would indicate what happened, yes.

Sir, we have marked previously I believe as Exhibit 26 a short form examiner's report about McDonnell & Company dated April 24, '69, and two what appear to be routing slips on top of that. I show that to you (handing).

Q Have you had a chance to read that, sir?

A I haven't completed reading the memorandum.

(Pause)

Q Sir, it's somewhat long. Maybe I could just pinpoint a question or two on the page you are on now. Not the first page, the top of the examiner's report. I believe it says here, if I may, and this is a note that appears to be from Mr. Stock to Mr. Spies,

"I would like to bring this 325 charge soon."

Do you recognize Mr. Stock's initials under that?

A Yes, sir.

Q It was RAS to Mr. Spies?

A Yes.

Q Do you know what 325 charge Mr. Stock was referring to?

A Rule 325 charge, the capital requirements charge.

Q Is this a charge procedure that the exchange has for bringing a formal charge?

A Reporting it to the board of governors, yes.

Q Is there something called a charging memo that is drawn up?

A Yes.

Q Then on the top page, sir, there is a note that appears to be on the slip of Fred J. Stock, again from Mr. Stock to Mr. Spies:

"I'll have GHN include 325 in memo with other charges."

Was GHN yourself, sir?

A Yes, sir.

Q Were you in the process or under instructions at that point to put together a charging memo?

A It would appear that I had already started on preparing a memorandum.

MR. BROOKS: Your Honor, I move to strike the testimony unless Mr. Newman can testify of his own knowledge as to the answer to the question.

THE COURT: Strike it out.

Q Sir, looking at these, is your recollection refreshed that you are indeed involved in already starting?

A Yes.

Q Who instructed you to prepare a charging memorandum against McDonnell in late April 1969?

A The memorandum is from Fred Stock.

Q Would that refresh your recollection that it was Mr. Stock?

A Yes.

Q Sir, were the charges brought?

A Pardon?

Q Were the charges brought then in late April 1969, or were they dropped?

A No, they were dropped, but I don't remember if it was late April of 1969.

MR. BROOKS: Your Honor, I would like to correct what I think is an error in the record. Mr. Beebe described this exhibit as Exhibit 26. I believe it should be identified as Exhibit 22 he is questioning the witness on. I think the record should reflect it is Exhibit 22.

MR. BEEBE: All I can say is what my records say is it is 26, but whatever the record is I will abide by that. Can we do that afterwards?

MR. BROOKS: Are we talking about a short form

examination?

MR. BEEBE: I am not prepared to answer questions on it right now.

MR. BROOKS: I just want to get it straight.

We have the exhibit. It is 22, your Honor. Mr. Beebe has it as 26.

THE COURT: You can resolve that at four-thirty.

Q Do you remember any meetings during that period with Mr. Stock on the subject of McDonnell & Compan-?

A I don't recall any specific meetings. We had meetings day to day. It could very well hav ebeen McDonnell & Company, it could have been other firms, it could have been several firms at the same time. Yes, there were meetings, in answer to your question; yes, there were meetings.

Q That concerned McDonnell & Company?

A Yes.

Q Do you remember the subject ever being raised whether or not the charging memo should be filed and the charges brought, or whether they should be delayed? Does that refresh your recollection at all?

A No.

Q Do you recall any discussions about imposing restrictions or not imposing restrictions?

A Yes. There were conversations about imposing

restrictions when I became coordinator.

Q Do you recall any discussions about delaying the imposition of restrictions?

A No. I don't recall any conversation about delaying the imposition of restrictions.

Q I show you a document which was marked at the deposition, a memorandum dated May 2, 1969.

MR. BEEBE: I ask it be marked as the next exhibit for identification. You might give it an A number.

(Plaintiff's Exhibit No. 55-A was marked for identification.)

Q That is addressed to you, is it not, Mr. Newman?

A Yes, sir.

Q From Mr. McChesney?

A Yes.

Q Who is Mr. McChesney, please?

A Who is he?

Q Who was he at that time; what position did he hold?

A I believe at that time he was the chief examiner.

MR. BEEBE: I offer this in evidence.

MR. BROOKS: No objection.

(Plaintiff's Exhibit No. 55-A was received in evidence.)

MR. BEEBE: I would like to read this document from

Mr. McChesney to yourself dated May 2, 1969:

"This firm is not" underlined "on the restricted list. At the April 29th meeting it was stated that the firm has 'voluntary'restrictions. What are they? Do we have a letter from McDonnell advising the Exchange of such items? Are they being observed?"

Q Do you remember getting that memorandum?

A Yes, I do.

Q And what did you do in response to it?

A I don't recall what I did.

Q Do you remember any discussion in that period of time, April - May 1969, about gradually liquidating McDonnell & Company?

A No, I don't recall any conversations at that time. There may have been some, but I just don't recall.

MR. BROOKS: I move to strike there may have been some.

THE COURT: Yes, strike it out.

Q When a brokerage house is liquidated, what does this mean? Could you explain to the jury what this means in terms of the firm's operations?

MR. BROOKS: I am going to object, your Honor. I don't think there is a foundation laid for this testimony.

Q If you know, sir.

BEST COPY AVAILABLE

THE COURT: Well, have we gotten down to the point there was any discussion of that being done?

MR. BROOKS: There has been none.

THE COURT: Sustained at this point.

Q The question is, sir: What happened, apart from what was discussed?

THE COURT: The objection is sustained. There is no foundation to the question at this point.

Q Sir, were some branches of McDonnell & Company sold shortly after that May 2nd memorandum?

A I don't recall whether they were sold shortly after or before, but McDonnell did dispose of some branches.

Q Shortly before or after this?

A I don't recall the exact time.

Q In this time frame?

A In 1969.

Q In mid 1969?

A I don't know.

Q Did it reduce the number of its customers at that time?

A I don't know if it reduced it atthat time, but certainly when the branches were disposed of the number of customers was reduced.

Q Was one consequence of shutting down branch offices

and reducing customer accounts to reduce the assets of the company?

A Not to my knowledge.

Q Do you recall attending a meeting on June 25, 1969, with Exchange personnel and Mr. Murry McDonnell?

A Not at this date, no.

Q Let me show you a document memo that has previously been marked Exhibit 3, according to my records.

THE CLERK: That has already been received in evidence as Exhibit 3.

MR. BEEBE: Yes, already marked.

MR. BROOKS: Would you describe it, Mr. Beebe?

MR. BEEBE: A June 25th memo.

MR. BROOKS: We have as Plaintiff's Exhibit 3 a subordination agreement.

MR. BEEBE: I show this to counsel for the New York Stock Exchange. If he will concede it is in evidence we will get the number on the record in a little while.

I have an Exhibit 27 indicated here as the number.

MR. BROOKS: I concede that Exhibit 27 is in evidence.

Q I show you Exhibit 27. Have you had a chance to review that, sir?

A No.

THE COURT: Put a question and see if he needs to review it.

Q Does that refresh your recollection at all that you attended that meeting?

A Not at this date, but my name is mentioned so I must have been at the meeting.

Q This memorandum mentions that Mr. McDonnell said at the meeting he was working on adding approximately 3.5 million dollars before the end of July to the firm's capital. Do you recall if that sum, or anything in the neighborhood of that sum, was added to the firm's capital at that point?

A No. The memo says --

THE COURT: The question is whether you recall.

A No, I don't recall.

Q Do you recall any discussion at the Exchange, apart from this meeting, in that time frame -- June 1969 - early July -- concerning the possibility of shutting McDonnell down, or suspending their operations.

A Not within that time frame, no, sir, I don't recall.

Q I believe you testified that the charging memorandum was not filed and the charges were not brought back in April; is that correct?

MR. BROOKS: I don't think he has testified to that.

A I don't recall saying that.

Q Do you recall if charges were filed?

A I don't think they were, because I had not been in the position long enough to prepare a memorandum at that date.

Q You don't recall them being brought?

A I don't recall, no.

Q Before this June 1969 meeting, do you?

A No, I don't recall.

Q There were no charges brought?

A I don't recall.

Q Do you recall any discussion back in the Exchange as to renewing the charging, the drafting of the charging memorandum, and going forward on that subject?

A Renewing the charging memorandum?

Q Bringing it up again, bringing the charges, going forward against McDonnell & Company.

MR. BROOKS: I object to the question.

THECOURT: Read it back.

(Question read.)

THE COURT: I sustain the objection as to form.

Q Do you recall any discussions in June or July 1969 about fining McDonnell & Company?

A About fining McDonnell & Company?

BEST COPY AVAILABLE

Q Yes, imposing, the Exchange imposing a fine on them.

A I dont recall those dates; no, sir.

Q Turning to page 2 of that memorandum it reads, after this discussion about bringing in more capital: :RMB mentioned that Bache & Company was looking for branches and Mr. McDonnell said he had heard that Shearson, Hammill and Thomson & McKinnon were looking, too."

Do you recall that McDonnell & Company was selling some of its branches to other brokerage houses in that period?

MR. BROOKS: I object to the form of the question. The recitation from the exhibit --

THE COURT: Yes, sustained.

MR. BROOKS: -- is uncalled for, because he can ask the question without that.

Q Apart from the exhibit, sir, do you recall in June or July of 1969 that McDonnell & Company was selling its branches?

A I don't recall the specific dates of June or July.

Q Looking at the memo, and particular companies mentioned here, does that refresh your recollection?

A It doesn't refresh my recollection; no, sir.

Q Turning to page 3, sir, the second paragraph reads: "Mr. McElroy and McDonnell" -- I assume that is Murray

BEST COPY AVAILABLE

McDonnell -- "were to review the corporation's proprietary positions later that afternoon to determine where liquidation could be made."

Do you know what liquidation was being referred to at that time?

A Referring to the proprietary positions.

Q Would you explain what liquidation of proprietary positions means?

A Selling.

Q What does a proprietary position mean?

A The firms inventory, the firm's securities.

Q Securities owned by the firm?

A Correct.

Q On page 4 --

MR. BEEBE: I will have to withdraw that. I can't find the reference I thought was here.

Q Referring to this liquidation of proprietary positions, sir, does that refresh your recollection that McDonnell was engaged in liquidating its assets at that point?

A No, sir.

THE COURT: Are you going on to another exhibit?

MR. BEEBE: Yes, your HOnor.

THE COURT: We will recess until ten in the morning, ladies and gentlemen. Heed my customary admonition, please.

(Adjourned to May 7, 1975, at 10:00 a.m.)

MARGARET MARY McDONNELL MURPHY, et al.
vs.
McDONNELL & CO., INC., et al.

May 7, 1975,
10 A.M.

--

(In open court, jury present.)

G E O R G E H. N E W M A N, resumed.

DIRECT EXAMINATION CONTINUED

BY MR. BEEBE:

Q Mr. Newman, yesterday we left off at the point of June 25, 1969, and you were saying that there were no fines or charges brought at that time as far as you remember; is that correct?

A Correct.

Q Do you know of any reason why fines or charges were not imposed at that time, sir?

MR. BROOKS: I object, your Honor. There is no foundation for the question. There hasn't even been determined to be a violation for which he should impose a fine.

THE COURT: Yes, as to that particular question the objection is sustained.

Q Sir, was there any discussion at that point about the imposition of fines or bringing the charging letter at that time?

A Not that I can recall.

Q Considering the condition of the company at that time, as you recall it, is it your view and was it your view at the time thatcharges should be brought?

MR. BROOKS: Object.

THE COURT: Sustained.

As an individual?

MR. BEEBE: I meant in his capacity as a co-ordinator making recommendations, his view as the man on the scene who was in charge of McDonnell Company among, I believe 110 companies that were under his authority.

THE COURT: Well, is the record established that it is his position to make such an assessment and that he has the facts and that it is his job? It would seem to me if it is an official who did not have that task, Mr. Beebe, that that statement of opinion is inappropriate for this gentleman.

MR. BEEBE: I believe his task was, sir, to make assessments as to whether a company was in apparent violation or not.

THE COURT: That's one thing.

MR. BROOKS: I don't think the witness has testified to that, your Honor. He testified that he got information from certain sources and he passed it along

to other sources and coordinated the information. I don't recall him testifying about making assessments yet. Maybe he will.

THE COURT: I will sustain the objection.

Q Sir, was it your job as coordinator to gather together the facts about the financial and operating condition of the company that was involved?

A Yes, sir, the facts would come to me.

Q And would you put the facts together in a memorandum and order them along the lines of whether or not the firm was in compliance with the exchange rules?

A Not always in memorandum form. We would have a coordinators' meeting, I believe at that time it was once a week, and we would discuss various firms. So that it was not always in memorandum form. Verbally.

Q Some of it was verbally?

A Yes.

Q Was the purpose of those coordinator meetings to assess whether or not the firm was in apparent violation of the rules or was in compliance with the rules?

A The purpose of the coordinators' meeting was to inform the senior staff of the condition of various firms and the progress that was being made in correcting deficiencies, if there were any.

Q Considering McDonnell's condition at that point, were there deficiencies?

A At that point. I'm lost again at which point.

Q Let me remind you. June, 1969, sir.

A I don't recall.

Q Say the summer of 1969.

A I don't recall.

Q Do you recall if at any time after you became in charge of McDonnell & Company, and I believe your first testimony yesterday was that they were in a precarious position. That's how you found them. Were you at any time aware of deficiencies at McDonnell & Company?

A Yes, I was.

Q And what were the deficiencies and when were you aware of them?

MR. LOFLIN: I object, your Honor. This seems to me to be needlessly repetitious and cumulative at best. We have documents in the record now that show various reports in writing given as to the status of McDonnell & Company at various periods of time and to have this witness go through all of that again, which this question apparently calls for, I think it is just unduly burdening the record and protracting this proceeding.

THE COURT: I agree with you in part but I will

overrule this particular objection.

What were the deficiencies and when did you first become aware of them?

THE WITNESS: Well, the deficiencies were in the record keeping area primarily, initially.

Q And when was that, sir?

A I don't recall. It must have been shortly after I became a coordinator that I became aware of it.

Q After you became aware of the record keeping deficiencies what were the next type of deficiencies you became aware of at McDonnell & Company?

A It would be the capital position of the firm.

Q Would it be fair to say that this was some time in the late spring and summer of 1969 that you became aware?

THE COURT: I sustain the objection to that. That gives no time at all.

Q When was that?

A I don't recall the time.

Q Sir, are you familiar with the limited partnership -- I believe there used to be a limited partnership named DuPont Homesy.

A Yes.

MR. BROOKS: I object.

MR. BEEBE: I am going to tie this in.

THE COURT: What is the relevance? Is this something you should tell me at the side bar?

MR. BEEBE: No, this is very straightforward in relation to something that's been in dispute somewhat at the trial already and it ties into when he knew something. If I can just bring out some foundation--

THE COURT: Let's take a few questions and see where it goes. Overruled.

Q Did DuPont Homesy go out of business?

A Yes.

Q When was that approximately?

A I don't recall. I think it was in the late '50s, but I can be wrong.

Q Are you familiar with knowledgeability letters?

A I was familiar with them, yes.

Q At the time you worked at the exchange?

A That's correct.

Q When did knowledgeability letters fir come into existence?

A I don't recall the date or the year.

Q Were they in existence before you were a coordinator at McDonnell & Company, in other words, before the middle of 1969?

A I believe they were.

Q More than a year before?

A I can't say.

Q Let me refer to your deposition two years ago, page 224.

"Q Do you know why the New York Stock Exchange required a knowledgeability letter be submitted by either a new capital contributor to a member firm or a renewing capital contributor to a member firm?

"A This goes back into history, if my memory is correct.

"Q I am here to listen.

"A I think it all started with the limited partnership of DuPont Homesy, and over the years there was talk of having so-called knowledgeability letters obtained from all capital contributors. But the feeling was why penalize all firms for the fault of one, and so it was never formally adopted until some time after the DuPont Homesy instance."

Is that your testimony, sir?

A That's correct.

Q Were knowledgeability letters required in some cases after the Dupont Homsey incidents but not normally applied to all members until a later date?

A I don't recall.

Q We have had a lot of talk about knowledge-ability letters.

I show you a document that's been previously marked 56A for identification.

MR. BROOKS: No objection.

MR. BEEBE: Offer it in evidence.

THE COURT: It may be received in evidence.

(Plaintiffs' Exhibit 56A is received in evidence)

Q Sir, was 56A a letter prepared by you for someone else's signature?

A At the bottom of the letter there are three sets of initials, including mine. So that somewhere along the line I was part author of this letter.

Q Attached to that, is that a form of knowledge-ability letter?

A Yes, it is.

Q And is the firm being required to obtain knowledgeability letters from new capital contributors in view of its capital and other condition?

MR. LOFLIN: Objection, your Honor.

THE COURT: It's in the letter. Sustained.

MR. BEEBE: Could I just read the last paragraph?

THE COURT: You may.

(Last paragraph of Plaintiffs' Exhibit 56A in evidence read to the jury)

Q Sir, in your deposition testimony, which we just read back, you said that "Why penalize all firms for the fault of one."

Could you explain in what respect a knowledgeability letter is a penalty?

A Well, I may have used the word penalize incorrectly. Perhaps a better word would have been why put all firms through the trouble of obtaining a knowledgeability letter because of the fault of one.

Q What is the purpose of a knowledgeability letter?

A Well --

MR. BROOKS: I object. I don't think there has been a foundation laid for whether this witness knows.

THE COURT: Yes, sustained.

Q Do you know, sir, what the purpose was of the

knowledgeability letter that was part of the letter or an attachment to the letter that you helped to prepare?

A Well, it was --

THE COURT: The question is do you know the purpose? That calls for a yes or a no.

THE WITNESS: Yes, I do.

Q Could you explain the purpose, please.

A That the lender would go into the loan with his eyes wide open.

Q Sir, moving on, was there a meeting on July 22, 1969, concerning the valuation of letter stock and the federal income tax refund that McDonnell & Company was claiming as good capital?

A The date doesn't do a thing for me.

Q Aside from the date, sir. I don't mean to pin you down to a particular date. Do you recall such a meeting later on in your duty as a coordinator in that time frame?

A No, I don't recall at this date.

Q A meeting with Mr. Bishop and Stock and McChesney.

THE COURT: Is there a memorandum, Mr. Beebe?

MR. BEEBE: I will certainly work from that

then, your Honor.

(Plaintiffs' Exhibit 56 was marked for identification)

THE COURT: Are you offering it?

MR. BEEBE: Yes.

THE COURT: Any objection?

(Plaintiffs' Exhibit 56 was received in evidence)

Q Before you turn to that, Mr. Newman, let me read to the jury the knowledgeability letter, and you can read yours at the same time, if you want.

(Attachment to Plaintiffs' Exhibit 56A in evidence was read to the jury)

Q Mr. Newman, were knowledgeability letters required of McDonnell & Company's subordinated lenders or capital contributors or purchasers of its common stock befoer May 21, 1969?

A I don't recall.

Q Turning to the next exhibit, 56, Mr. Newman, you were the author of this memo, were you not?

A Yes, sir.

Q Do you recall the occasion for this meeting? Do you recall what the purpose of the meeting was?

A May I read the memorandum?

Q Certainly.

I will read to the jury and we will all know where we are.

(Plaintiffs' Exhibit 56 in evidence was read to the jury)

Q Now, do you recall the purpose of your having met with Messrs. Stock, Bishop and McChesney?

A No, I don't recall the specific purpose.

Q Weren't you reporting to Mr. Lind -- that's a man at McDonnell & Company -- that Mr. Bishop and Stock and McChesney were rejecting Mr. Lind's proposal to use these assets as good capital under rule 325?

A Yes.

Q Was Mr. McChesney higher than you at the exchange in terms --

A Yes, sir.

Q He was.

On the last page when Mr. Lind said he would explore furtherwith Mr. McChesney, is that another way of saying he was going to go over your head?

THE COURT: Sustained.

Q Did he tell you what his purpose was of going to Mr. McChesney after you had reported to him?

A Well --

THE COURT: No, did he tell you?

THE WITNESS: No.

Q What was the basis of your telling Mr. Lind, after meeting with Mr. Bishop, Stock and McChesney, that the letter stock wouldn't be considered good capital? I will take them one at a time.

MR. BROOKS: What relevance does the purpose to have?

MR. BEEBE: I didn't say the purpose. I said the basis. Perhaps I didn't speak clearly. I said the basis for his advice.

MR. BROOKS: I withdraw my objection.

THE COURT: All right.

A Would you repeat that again, please?

THE COURT: Let me ask you, Mr. Beebe, is it going to be more than what's in the memo?

MR. BEEBE: Yes, I would like it established firmly that letter stock was not considered good capital.

MR. BROOKS: We have testimony how letter stock figured into the capital computation or did not fit in.

MR. BEEBE: I feel this witness should be free to testify because later on I anticipate some contradictory testimony and I only have one chance of Mr. Newman's view of what was going on.

A Letter stock was not good capital.

THE COURT: All right.

Q Was federal income tax refunded good capital?

A No.

Q I believe there was an MF circular issued to the department of member firms on the income tax refund which addressed this particular subject. Is that your recollection?

A That is my recollection, yes, sir.

MR. BEEBE: I would like this document marked next in order for the plaintiff.

There is no relation between this number and the 57 that has been marked previously.

(Plaintiffs' Exhibit 57A was marked for identification)

MR. BEEBE: I offer that letter as the next exhibit.

THE COURT: Mr. Brooks, any problem with this?

MR. BROOKS: Your Honor, I don't dispute it is genuine, we furnished it at Mr. Beebe's request. It has a date of 1963. I have some question about its relevance to affairs of 1969. I think it should be connected up with 1969 through the witness before it's admitted.

MR. BEEBE: I think I can do that even more quickly. It was produced in response to a subpoena asking for the MF circular pertaining to

treatment of tax refunds.

THE COURT: Overruled. The exhibit will be admitted in evidence.

(Plaintiffs' Exhibit 57A was received in evidence)

MR. BEEBE: I propose not to ask you any questions on that particular memo right now. It's been introduced because it has something to do with the subject matter. I would just like to read from paragraph 2, which pertains, I believe, to capital assets.

The second subject in the last paragraph is "Members and member organizations are cautioned that a receivable for income taxes recoverable under a loss carryback provision of tax laws should not be considered as a quick asset when computing net capital under rule 325 until it has been established the payment will be received within the next 30 days."

Q When Mr. Lindh told you as reported on the second page of your memorandum of July 22 that he was going to talk to Mr. McChesney about the possibility of getting some credit for the tax refund and the letter stock, did he offer any explanation or basis for his not accepting what you had told him?

A I don't recall.

Q Was he asking for an exception to the application of what you had said was the provisions for not accepting letter stock and tax refunds as good assets?

MR. BROOKS: I object to the question, if it's simply asking Mr. Newman to read what's in the memo, which has been read.

MR. BEEBE: I am asking beyond that.

THE COURT: It is overruled. Go ahead.

A I don't recall at this point.

Q That was July 22, 1969. I show you another memo with the same date which we have previously marked as Exhibit 57 for identification. I offer that in evidence.

Is that your signature at the bottom of that?

A Yes, it is.

MR. BROOKS: No objection.

THE COURT: 57 may be received.

(Plaintiffs' Exhibit 57 was received in evidence)

MR. BEEBE: I would like to read that one-page memorandum.

(Mr. Beebe read to the jury from Plaintiffs' Exhibit 57 in evidence)

Q Who is Mr. Arning, Mr. Newman?

A Who is Mr. Arning?

Q What position did he hold at thattime, sir?

A Vice president. Or perhaps senior vice president. I don't recall exactly.

Q He was above the department of member firms in any case, was he not?

A Yes, he was.

Q Do you know if Mr. Arning had the authority to make an exception to rule 325?

MR. BROOKS: Your Honor, I object.

MR. BEEBE: What is the objection?

THE COURT: Overruled. It calls for a yes or no. Do you know?

A No.

Q When you say "no" you don't know whether he did or, "no, he did not"?

A No, I don't know.

Q Sir, we have ssen some chronology of events at McDonnell & Company. I show you Exhibit 58 for identification, and ask you if you have seen that.

A And ask me if I have what?

Q Have seen that, sir. Will you look it over quickly (handing to witness).

MR. BROOKS: Your Honor, I object to the pencilled markings on the exhibit which were not on the exhibit when it was marked at deposition. There are makings on pages 3, 4 and 6. We would volunteer a clean copy as a substitute.

THE COURT: Very good.

MR. BROOKS: We would also ask for some identification of this through the witness, since it doesn't appear to be signed.

MR. BEEBE: I haven't offered it yet. I know there are pencilled markings on the one handed to me, too. Let's work from that one, sir, if we may.

I will just be the clerk for the minute and put 58 on top of this.

Here you are (handing to witness)

THE COURT: While this gentleman is examining this exhibit, could I being you around to the side bar.

(At the side bar)

THE COURT: I can appreciate your getting out the facts here, but in terms of the minute day-to-day detail that we are going into, what is the theory here of liability that gets us down into this minute by minute situation in June and July of 1969? All the money is in, all the stock is bought, all the loans are subordinated.

MR. BEEBE: Let me address that, sir.

In the first place, I have cut out a great deal of the minute by minute. I am trying to get the highlights. For instance, this is a compilation of a lot of other things and I don't plan to go through it line by line.

THE COURT: This is not being critical. This is in order that I might make an assessment here to perform my function. It's a question of what is the relevance of this in terms of legal effect.

MR. BEEBE: Of course. Sir, I think that you have here, continuing through the summer into the fall, an area which we will cover I would say in the next hour or so, or perhaps less, a continuing suppression by the exchange and McDonnell & Company, but particularly the exchange, of the facts, and a continuing refusal to act, to take steps, which will all be brought together through various witnesses.

As you know, every time I ask this one why they didn't do something he disclaims knowledge. We might put on other witnesses who have further knowledge as to why precisely they didn't do those things. It's a building block process.

With regard to the timing of the trial, I have

made a reassessment of the various witnesses and needs for introducing facts so as not to be in any way accumulative or putting in more than we need to put in.

I am now of the view that I may be finished by Monday or Tuesday of next week. When you mentioned four weeks the other day, sir, it gave me pause.

THE COURT: Originally, both sides had estimated a total of two weeks when I selected the jury.

MR. BEEBE: There has been a lot more difficulty I have had in getting in documents than I anticipated.

THE COURT: I still haven't gotten from you a statement as to why the events of the summer are relevant as a matter of law.

Do you claim that something happened differently? It seems to me that for your purposes the monies are in, the exchange has made its deception, or so you claim, has failed to notify, as you claim, and the stocks are bought. What do the events of the summer have to do with the issues?

MR. BEEBE: I can assure you it ties together with the witnesses as we go up the chain to show a continuing scheme and plan which was in operation going back into the time of the witnesses, and the time before

my clients put in the money, all of which prove the fact that the whole plan was in place during the time when our people were being asked to tender their money.

I assure you, sir, that it connects quickly and firmly.

Q You mean a scheme or plan by the members of the exchange?

MR. BEEBE: To cover up.

THE COURT: To cover up?

MR. BEEBE: That is exactly right, sir.

MR. BROOKS: Your Honor, I recall that there was an attempt to amend the pleadings in this case to plead such a scheme or plan and that that was rejected by the court.

I think if that is Mr. Beebe's theory now it is been ruled out of this case.

MR. BEEBE: Sir, we are not claiming, if that is what that is alluding to, a conspiracy. We are showing the motivation for the exchange's actions, not completely through this witness, I made no pretense this witness was aware of all the plans that were going on. He was reporting facts. The higher ups were not acting on the facts. Why not? We can't prove that through this witness, but I shall proveit.

I also would point out that the later events show what they should have been doing earlier as clear circumstantial evidence, which will come in a few minutes, even out of this witness, of what should have been done long before our people came in and should have been part of

the exchange's activities and actions, firm actions, which they didn't take.

Why they didn't take it, that will emerge the next few days.

MR. LOFLIN: I must say I find this puzzling. We are going to be told apparently through this witness and others some facts that occurred during the summer of 1969 and somehow that is going to explain why action was not taken the preceding December, 1968, or January, 1969. I certainly doubt that as a matter of history or logic.

THE COURT: That is what puzzled me and occasioned me to summon you to the side bar.

MR. BEEBE: I don't make any pretense it is this witness, but this witness proves what they knew and didn't act upon.

THE COURT: This is going to be, in effect, the equivalent of a-- in some way the subsequent conduct is going to be proof of the intention as to the earlier conduct, is that what you are saying?

MR. BEEBE: And prove the conduct and plan continued in place throughout that summer because there is no other explanation.

THE COURT: When you say plan, what is the plan? You are not talking about a group of people sitting around

and sayibg "We are going to hide this from the public".

MR. BEEBE: I think I am, and I think I can prove that.

THE COURT: You mean a conspiratorial type of plan, is that what you are saying?

MR. BEEBE: It is something that will emerge from the higher ups as called, will be in the next few days.

THE COURT: Are you going to establish any motive for this plan?

MR. BEEBE: Yes, sir. That is exactly what I intend to prove, because there is no other explanation. Why did these people do what they did at the stock exchange when confronted with all this evidence and strong indications of what the condition was at McDonnell & Company, so well proved that everyone here thinks I am proving it over two or three times, and did nothing. That is the question that is going to be answered by the witnesses, and evidence that is going to come in.

THE COURT: Mr. Beebe, let's get to that rather than getting into his recollection of did he hear a little bit more or less on a phone conversation then, because if you say that that proof you expect will emerge we don't really need to get into all of the minute detail about these July conversations, for example, where he obviously has no

memory. You can ask it three different times if he remembers something with McChesney and he says he doesn't recall.

MR. BEEBE: I have given up, and that's why I read the exhibit.

THE COURT: You and I don't recall whatwe did a year ago, so how can you expect him to remember back six years.

MR. BEEBE: With respect to letter stock, the knowledgeability letters, they are going to try to show these things were all perfectly normal and good things for the exchange to be moving these things around, and I have to have a chance to meet that.

THE COURT: I appreciate that.

MR. BEEBE: That is one of the reasons.

THE COURT: I treat everything said here as controverted, so you don't have to put any vigorous denials on the record at this point, Mr. Brooks.

MR. LOFLIN: I have one thought and it will be brief. I must say this theory is not persuasive over here, but that wouldn't surprise anybody. It seems to me the record of this case has shown at various times in 1969 prior to the period we are now in -- that is, June and July of 1969 -- that McDonnell & Company was in capital

compliance. If I understand what Mr. Beebe is saying that is inconsistent with that possibility. He has succeeded in showing among his many documents that from time to time McDonnell in fact was in net capital compliance.

MR. BEEBE: I don't think the documents show that at all.

May I say one other thing--

THE COURT: I appreciate your observation here as well, Mr. Loflin.

MR. BEEBE: One other thing proved in that summary. A great deal was made on the cross-examination, as you may recall, of whether Anna McDonnell had signed a new subordination agreement in 1966, which didn't seem to bear very much on what's going on here. But I think that what they are focusing on, and what they are making a big thing about, is that there was a hundred day notice provision in there, so that if -- perhaps they are reading as saying if they blew the whistle, or someone came in on her behalf and said a hundred days cut off, let's pull our money out, I don't know if that is how it reads, but all of them were lulled into inactivity not to push the panic button because it was a closely guaded secret as to what was really going on at McDonnell & Company and that secret started to unfold and the word started to

get out finally when they started to put the restrictions on in May,but that took a long time to get out and it was not until the beginning of next year something happened.

THE COURT: It seems to me, if memory serves me, and our discussing the facts are really of no relevance, but didn't Paul McDonald have a meeting some time in the fall in which he said there is only one way to save this company, and Jim said I think you ought to fold up and everybody was against him.

MR. BEEBE: That's right.

THE COURT: If the whistle was blown certainly at that meeting there was a lot of noise.

MR. BEEBE: I am talking about the fact the exchange didn't do anything.

THE COURT: But at this point one could argue if Anna McDonnellor her representative, or Jim, or anybody else wanted to pull out, at that point they knew.

MR. BEEBE: That brings in another theme--

THE COURT: This is a lovely discourse but --

MR. BROOKS: I have a procedural point. I have prepared a memorandum of law on a possible point which will come up. I would like to submit that to you after the break.

THE COURT: Very good. All right.

(End of discussion at the side bar.)

(In open court, jury present.)

THE COURT: Has that given you enough time to look at that memorandum?

THE WITNESS: Yes, it has.

Q Mr. Newman, I assume that you have not committed it to memory yet. Could you look at the top left of the front page and I ask if that is your initials there?

A Yes, sir.

Q Under SOQ -- is SOQ in your handwriting?

A Yes, sir.

Q Does your handwriting appear elsewhere in this memorandum also? At the bottom of the front page you will notice there is an insert.

A No, it does not.

Q And later on there is some other writing.

(No response.)

Q You say it does not?

A No, sir.

Q What was the occasion of your writing up in the upper left-hand corner SOQ and your initials?

A What was the occasion?

Q Was this a procedure when you received documents to send them to the SOQ file after reviewing them?

A Well, whatever file was applicable, yes.

Q And is that what the indication up in the corner means, that you sent it to the files?

A That's correct.

Q Did you read it before sending it to the files? Would that be your procedure at that time?

A Yes, it would.

MR. BEEBE: I offer this as the next plaintiffs' exhibit in evidence.

THE COURT: Any objection, Mr. Brooks?

MR. BROOKS: I have no objection, your Honor. It is a genuine document. But since the witness did not prepare it the question how relevant it is to the examination of Mr. Newman arises.

THE COURT: Let's admit it in evidence, and we will deal with it accordingly. It may be admitted.

Q Do you know who prepared it, sir?

A No, sir, I don't.

(Plaintiffs' Exhibit 58 received in evidence.)

Q Sir, I direct your attention to page 5, the entry under April 21st and April 22nd, the bottom two entries on the page.

THE COURT: It just occurs to me: ladies and gentlemen, I want to say to you that as and when appropriate at the end of the case and in the course of your deliberations

you are going to have available to you this entire mass of documentary material, so in case you think we are keeping something from you, we are not. It is just that in the course of getting the evidence in, so it is in the record and arguably from and before, parts of it the attorneys have chosen to read to you as they felt it was relevant at the time. Mr. Brooks gave you an exhibit to look at that was in evidence when he was examining the witness about it. The fact that all of us hear of it and you, who are the triers of the fact don't have it, doesn't mean you aren't going to be given all of this material at the close for your consideration.

Go ahead, sir.

Q Sir, do those two entries at the bottom of the page there concerning liquidating of proprietary positions and trading positions stir any recollection in your mind as to whether or not McDonnell & Company was liquidating its assets starting in April, 1969?

A No, it doesn't.

Q Now, sir, I ask you if you recall a transaction involving a company called Scheinman Hochstein & Trotta with regard to the McDonnell & Company?

A A transaction?

Q Yes. In 1969. Does that ring a bell at all?

A Yes, it does.

Q Would you explain what the transaction was to the jury?

A If my memory serves me correctly, the transaction involved the taking over of a branch office of McDonnell.

Q I show you Exhibit 59 for identification. Are those your initials at the bottom, sir?

A Yes.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: I have no problem with the exhibit itself. There is some scoring on the exhibit that was not on the at the time of the deposition, but I will submit a clean copy.

THE COURT: 59 for identification is received.

(Plaintiffs' Exhibit 59 received in evidence.)

MR. BEEBE: I would like to read this document to the jury.

(Mr. Beebe read to the jury from Plaintiffs' Exhibit 59 in evidence.)

Q So that was a purchase of McDonnell Management Company, is that right?

MR. BROOKS: I object to that.

THE COURT: Yes. Sustained.

Q Does that refresh your recollection as to

pinpoint the subject matter we are talking about as to what it was that Scheinman was buying?

A Yes.

Q Do you know if that transaction materialized; that is, did Scheinman buy McDonnell's Management Company?

A I don't recall whether they did or not.

Q Let me read the last page.

"However, Mr. Scheinman feels that there could not be a take-over until McDonnell& Company has had an audit and it was his opinion that even the audit was to start today, McDonnell would run out of money before the audit was completed."

How long does an audit take to complete, sir, in the normal course of the brokerage house's audit?

A I have no idea.

Q Sir, is there a rule in the exchange rules that allows 45 days for the normal outside audit?

THE COURT: Is this just to get an expression of fact or in the abstract, because that's cumulative.

MR. BEEBE: This is in terms, sir, when Mr. Scheinman says the company is going to run out of money--

THE COURT: I appreciate the juxtaposition which you wish to make, but as to this question haven't we had testimony that there is a 45-day rule and you can extend it?

MR. BEEBE: I am just trying to lay a time frame.

THE COURT: Objection sustained.

Q Were you aware at that time that McDonnell & Company would run out of money in 45 days or before an audit could be completed, whatever time that took?

MR. BROOKS: I object. The memorandum reports on a view expressed by Mr. Scheinman from another firm about McDonnell & Company. There is no foundation for any knowledge that Mr. Scheinman has. In any event, I think it is hearsay.

MR. BEEBE: It is precisely the question I asked this witness, this witness.

Q Were you aware, Mr. Newman?

THE COURT: Let me think about that one for a minute.

Go on to another subject.

Q Mr. Newman, after Mr. Scheinman told you this, what did you do with what he was expressing as his opinion of how soon the firm would run out of money? Did you take any steps with that information?

A I don't recall what I did.

Q You wrote this memo in any case?

A Yes, I wrote the memo.

Q Who was the memo circulated to?

A I can't tell. It is not legible.

Q In the normal course of things who would receive that memo or oral information about that kind of information being given to you?

A At that time I would have informed Mr. Stock.

Q Now, I would like to go back for a minute to 1968. I am just doing this here because I just have to get it out of the way at some point.

Mr. Newman, what was your position in October, 1968?

A October, '68, I was the manager of the Division of Finance.

Q And as part of that job were you involved at all with McDonnell & Company?

A Involved? I don't know what you mean by involved.

Q How would your job as manager of the Division of Finance relate in any way to McDonnell & Company in terms of supervision?

A McDonnell & Company's visit reports prepared by exchange examiners would come through my hands, as well as analysis of their questionnaires, financial questionnaires.

Q Did McDonnell & Company request at that time any treatment concerning arbitrage transactions?

A Sir, I don't recall.

MR. BEEBE: I would like to have marked as the next exhibit for identification a memorandum which appears to be from Mr. Newman to Mr. Jones dated October 24, 1968, handwritten.

(Plaintiffs' Exhibit 60 marked for identification.)

Q Is that your handwriting, sir?

A Yes, it is.

MR. BEEBE: While he is reading it, I will offer it in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 60 received in evidence.)

Q Sir, was Mr. Jones your boss at that point?

A Yes, he was.

MR. BEEBE: I would like to read this memo to your boss of October 1968.

Q I believe you were at that point in the middle of a discussionthat this reminds you about whether or not to use arbitrage as a good asset?

A Yes.

Q Before I read it, could you explain briefly for the jury the essential elements of arbitrage, if you can?

A That is the purchase of one security and the sale of another security, so that, in effect, you have an offset.

Q And I will read your memo.

(Plaintiffs' Exhibit 60 in evidence was read to the jury)

Q Was rule 325 amended thereafter to permit inclusion of arbitrage transactions?

A I don't recall.

Q Starting on a new area here, would you remember, coming back to the last memo we had in 1969, which was July 31, '69 -- I'm not asking you to look at it. Just in terms of where we were. The word you got

from Mr. Scheinman about his view of McDonnell's condition. Thereafter were you sent a press release by McDonnell & Company, and I show you Exhibit 60A for identification.

(Pause)

MR. BEEBE: I am trying to get a better copy of the press release which was introduced at the trial earlier.

MR. BROOKS: It is T, Mr. Beebe, I believe.

MR. BEEBE: This has previously been marked as T at the trial.

Q I was going to ask you some preliminary questions, sir, about the one I just handed to you. Is that your GHN stamp "received" on the top of the page?

A Yes.

Q The lefthand corner your initials?

A Correct.

MR. BEEBE: Offer it in evidence.

MR. BROOKS: I have no objection to Exhibit 60A coming in. I think we ought to note that Exhibit T is a clearer copy of the press release attached to 60A.

THE COURT: Very good. It may be received.

(Plaintiffs' Exhibit 60A was received in evidence)

MR. BEEBE: I would like to read the press release of August 1, 1969, from McDonnell & Company. For the sake of my eyes I'm reading from Exhibit T which we think is the same.

THE COURT: This is the proposed press release as far as this record presently shows.

MR. BROOKS: There has been no testimony that it was ever released.

THE COURT: Yes. This was sent to Mr. Newman by a Dorothy Ox.

MR. BEEBE: You are right. It was headed press release, which led me to say that. I think we will connect it later.

(Attachment to Defendants' Exhibit T in evidence was read to the jury)

Q Sir, after receiving a copy of that proposed press release what did you do with it?

A I sent it to the file.

Q And did you bring the information contained in that proposed press release to anyone's attention, sir? Let me focus particularly on the statement that the company had made arrangements for new capital in the

amount of 3 million to a maximum of $10 million.

A I don't recall that I did.

Q Did you know at that point, apart from the press release, of any basis for the statement in the proposed press release that the company was on sound financial footing?

A No, I don't recall, sir.

Q Was the press release carried over the Dow Jones ticker?

A I don't recall whether it was or not.

Sir, do you have a better copy of this press release? There is some writing in the lefthand corner that is completely impossible to read.

Q I don't. I wish I did because I think -- I don't. I will see if I can find one though.

THE COURT: Why don't we take our recess at this point and you can try ti find it during the break.

(Recess)

(In open court; jury present)

DIRECT EXAMINATION CONTINUED

BY MR. BEEBE:

Q Just before the break, Mr. Newman, I was asking you whether this press release was indeed issued by McDonnell & Company and went over the Dow Jones ticker?

A Yes.

Q Do you recall if it did?

A I don't recall.

Q I read from your deposition two years ago:

"Q Do you have any knowledge whether this press release was ever issued?

"A I don't know whether the release was in the same form as the press release, but I recall a release coming out on the ticker, the Dow Jones news ticker."

Is that correct?

A Yes, that's correct. Right.

Q And afterwards was there a newspaper article carried in the New York Times, do you recall that?

MR. BROOKS: Your Honor, I object, and move to strike the testimony. The deposition passage which was read said Mr. Newman didn't recall what the press release was that came out.

THE COURT: Yes, sustained. Strike it out.

Q When you received this release which we have marked in that letter from Dorothy Oakes from McDonnell & Company, was that your understanding that the release had been made by McDonnell & Company or was being made by McDonnell & Company?

A No. This was sent to me for informational purposes. I had no knowledge it was made or aboutto be made.

Q The attachment is headed press release.

THE COURT: Mr. Beebe, if you are trying to lay a foundation for proof of what went out, that isn't going to do it.

Q We have gotten a somewhat better copy here with a little more legibility of the initials that you are asking about before. Do you recognize the initials?

A I was asking about the writing. I dind't recognize the initials from the copy I have, but from this one I recognize the initials of Fred Stock.

Q Is Mr. Bishop's B there?

A Yes.

Q Does that indicate they received copies in the normal circulation of that press release or proposed press release?

A They may have just seen this copy, or

initialed this copy.

Q Sir, do you recall whether there was a story carried in the newspaper shortly after that proposed press release was sent toyou?

A My recollection is that there was an article in the paper.

Q I show you what we have marked Exhibit 61 for identification, and direct your attention to that article on that page. I ask you if thatis the story about McDonnell & Company that appeared shortly after you received the proposed press release (handing to witness).

Q I notice it's dated the next day.

A Your question then, sir?

Q My question is: Is that the newspaper story which appeared about McDonnell & Company the next day?

A This is a newspaper story, yes.

MR. BEEBE: I offer that.

Q It is headed: "McDonnell & Company finds financing"?

THE COURT: The exhibit speaks for itself in that regard. Any objection?

MR. BROOKS: I have no objection to it

coming in as a newspaper story that appeared in the New York Times on Saturday, August 2, 1969.

THE COURT: On that basis, Exhibit 61 may be received in evidence.

(Plaintiffs' Exhibit 61 was received in evidence)

MR. BEEBE: I will read the story.

(Mr. Beebe read to the jury from Plaintiffs' Exhibit 61 in evidence)

Q I take it you read this on the day it appeared in the newspaper or the Monday thereafter certainly?

A I don't recall reading the article. I believe I was on vacation; I am not certain. But I recall reading the article.

Q There was a statement in the press release and the article thyre was no change in majority control of the company or the top management. In one of the exhibits we marked earlier, of July 31, 1969, the day before the press release, your memo states "I mentioned to Mr. Lindh that I was surprised in talking to T. Murray McDonnell late yesterday after that he was not in attendance at the meeting.

"Mr. Lindh told me that T. Murray McDonnell

was represented by his long-time friend and adviser, Mr. Paul McDonald and that T. Murray McDonnell had authorized Paul McDonald to act on his behalf."

Was Paul McDonald coming in to assist the management of McDonnell & Company at that point?

A I don't recall when Paul McDonald came in.

Q Does this memo dated July 31, 1969, remind you that it was at or about that time?

A No, it doesn't.

Q Did you know Paul McDonald's reputation at that time?

A When I first met him he was presented to me as being a person who would assist corporations.

Q Certain kinds of corporations,sir?

A No, I don't recall. More or less of a consultant, I would guess.

Q Was hementioned at all when you first met him, when you learned about what he was known for doing, was the word "liquidating" ever mentioned?

A Not thatI can recall.

Q It doesn't ring a bell?

A No.

Q Going through the press release or the news story, sir, had you heard at the exchange about this

3 million to 10 million in new financing before the time of the press release?

A I don't recall.

Q You say you were on vacation around that time, sir?

A I said I am not sure.

Q I just thought I would refresh your recollection a little, that the July 31, 1969 memo indicates that it was signed by you. Would that remind you that you were at least there on July 31, 1969?

A Yes, it would.

Q Both the press release and the story say "The new capital is being supplied by private sources. The New York Stock Exchange has been advised of the arrangement."

Did you know if the New York Stock Exchange was advised of that arrangement?

A I don't recall at this point.

Q Did you or anyone at the exchange, to your knowledge, take any steps to check out the accuracy of the press release or the news story?

A Not to my knowledge.

Q The news story mentioned "Ten days ago it was disclosed McDonnell sold one of its three

memberships to the New York Stock Exchange because the firm's net capital position was approaching the minimums specified by the exchange."

Was it your knowledge at that time that McDonnell & Company had exceeded the minimums, and had done so for a long time before?

A No.

Q Do you know if the New York Stock Exchange, yourself or anyone else there, took any steps as a result of this story to disseminate other information about McDonnell & Company?

A No.

Q Did the three to ten million dollars come in, sir?

A I don't recall.

Q I show you a memo we premarked as Plaintiffs' Exhibit 62 for identification .

Let me ask you about Paul Fitzgerald for a moment. Was he also working in the coordinator's area when you were there?

A At that time he was my assistant.

Q And we attend meetings on McDonnell & Company when you were away on vacation?

A Yes, he would.

Q And would prepare a memo about his --

A He would attend meetings when I was on vacation, yes.

Q And he would prepare a memo about that meeting and send it to the files in the normal course of events?

A He prepared a memo.

Q And you reviewed it when you came back from vacation? Would that be the normal procedure, sir, to look at the file after you came back?

A I would look at the file, yes, right.

MR. BEEBE: I offer this as the next exhibit.

MR. BROOKS: I don't think Mr. Newman has said he has ever seen this. His initials don't appear to be on it, your Honor.

MR. BEEBE: In the normal course of things he said he would see it, and I don't see calling Mr. Fitzgerald just for this one memo.

THE COURT: Any problem with its authenticity?

MR. BROOKS: I will stipulate it's a genuine document from the exchange's files.

THE COURT: It will be received.

(Plaintiffs' Exhibit 62 was received in

evidence)

MR. BEEBE: I would like to read from this memorandum dated August 20, 1969, signed by -- initialed apparently by Mr. Fitzgerald, starting with the second paragraph.

(Mr. Beebe read to the jury from Plaintiffs' Exhibit 62 in evidence)

Q Does that memo, among other things, remind you that the three to ten million dollars had not yet come in, and may I ask you, did it ever come in?

A I don't recall.

Q Do you know if after August 20, 1969, when this memo was dated, at any time thereafter, anything was issued by the New York Stock Exchange or McDonnell & Company by way of retraction or correction concerning the press release and the article that appeared in the New York Times saying, among other things, that the firm was on sound financial footing?

MR. BROOKS: I object to the question insofar as it applies to the stock exchange.

THE COURT: Sustained.

Q I will take it a piece at a time--

A I don't recall --

THE COURT: There is no question before you.

Q Just as to McDonnell & Company, did McDonnell & Company issue any retraction or correction?

A I don't recall.

Q I will ask as to the New York Stock Exchange, did it issue anything that you recall with regard to that story that appeared in the newspaper?

A Not to my knowledge.

Q Let's take a block at a time starting then and going through to the end of the year. From August to September, I ask the same question as to the whole block of time, was McDonnell & Company suspended, charged, fined, or censured by the New York Stock Exchange in any way during that period of time?

A I don't recall the dates, no, sir. I have difficulty remembering some time what transpired two weeks ago.

Q Do you remember that something happened in January, 1969, concerning McDonnell & Co.? I might pinpoint that a little bit. A column appeared in a newspaper concerning McDonnell & Co. by Jack Anderson.

THE COURT: 1970?

MR. BEEBE: Yes, your Honor, 1970.

A No, sir, I don't.

Q I show you Exhibit 69 for identification. The pending question, sir, is: does that remind you there was a Jack Anderson column in January about that?

A I recall reading the article.

Q Do you recall receiving information before the article came out that Mr. Anderson was planning to write that article?

A I don't remember.

Q I show you Exhibit 67 for identification. Were you the author of that memo, Exhibit 67 for identification?

A Yes, sir.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: No objection to Exhibit 67.

(Plaintiffs' Exhibit 67 received in evidence.)

Q I think we went through the end of December, 1969. This takes us to January 22, 1970. Is it your recollection that no disciplinary action had been initiated by the New York Stock Exchange with regard to McDonnell & Co. prior to that date?

MR. BROOKS: I object to this piece by piece advance on this question. Mr. Newman has told us a number of times that he cannot recall when disciplinary proceedings were had.

MR. BEEBE: This is the last piece.

THE COURT: Let me hear the question.

(Question read)

THE COURT: I sustain the objection based on his answer to the last similar question in which he said he had no recollection of the periods.

MR. BEEBE: I would like to read from this memorandum which refers to the January 22, 1970, discussion with Mr. Paul McDonald at McDonnell & Company, starting

with the second paragraph.

(Mr. Beebe read to the jury from Plaintiffs' Exhibit 67 in evidence.)

Q Mr. Budge was with the SEC, sir, is that right?

A Yes, sir.

Q Actually, Mr. Budge was the chairman of the SEC at that point, wasn't he?

A I don't recall. I believe he was.

Q Did you send copies of this memo to Mr. Bishop and Mr. Stock? I direct your attention to the cc's at the bottom left of the front page.

A Yes, sir.

Q Do you know if the SEC had been planning to file its complaint before word came of the Jack Anderson column?

A No, sir. I don't.

Q Turning to the Jack Anderson column, did that column appear the next day or so in the newspapers, do you recall?

A I don't recall.

Q Do you recall there was a column that appeared?

A I recall reading the column, yes.

Q And this is the column you recall reading, is that right, or a copy of it?

A Yes.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: I object. It is highly improper, irrelevant, and not probative of anything.

THE COURT: I can see a number of reasons why this is inappropriate. Will you come to the side bar and see if there is any portion you feel is appropriate.

(At the side bar.)

MR. BEEBE: Your Honor, this is motivating force that galvanized them into action after months of sleeping on what they should have been doing.

THE COURT: Let's assume that that is so. The tenor of the comments here, as far as this trial is concerned, in my opinion, are opinions by a columnist and in this contention I would regard them as highly prejudicial.

If you want to in some way -- I mean Mr. Anderson is not here as a witness to be cross-examined on the quality of his observations.

MR. BROOKS: We also have deposition testimony by Paul McDonald that practically denies the thrust of this whole story.

MR. BEEBE: I think the evidence supports it very well, but in any case--

THE COURT: Mr. Beebe, I am not going to permit

it to go in in haec verba. Is there any portion of this that you feel is necessary. You claim after this article was printed certain things happened. Haven't you established your record perhaps sufficiently on that basis?

MR. BEEBE: If I could ask him, without going into the details of the column, whether the column was highly critical of the New York Stock Exchange for failing to act decisively, and particularly with regard to McDonnell & Company, and leave it at that--

MR. BROOKS: I object to that, your Honor. If he wants to show whether the exchange's conduct changed one whit after the article's appearance why doesn't he ask that question.

MR. BEEBE: I will show that without any doubt but I have to connect it to the article. I think the question is fair: was the article highly critical of the New York Stock Exchange for failing to act decisively against brokerage firms and particular McDonnell & Company. It is critical, and it does go into the state of mind of the stock exchange after this was published galvanizing them finally into action.

I think I can live without the column itself, although I would like to get it in evidence.

MR. BROOKS: There is no evidence at all that

I know of in this record that the exchange's conduct changed at all after January 23rd, or that this article had any effect at all on its conduct.

MR. BEEBE: The circumstantial evidence is overwhelming, and I will put in a lot more to prove it.

THE COURT: What is the question you want to ask?

MR. BEEBE: Was this column on or rabout January 23, 1970, appearing in the newspapers highly critical of the New York Stock Exchange for failing to act decisively against brokerage firms and McDonnell in particular?

MR. LOFLIN: I think it is highly prejudicial. Mr. Jack Anderson is widely known, and I don't know whether these jurors do or do not know him.

THE COURT: The prejudicial nature of that in this context you have no disagreement with me on, and I am not going to let the article go in. It is a question of whether to establish --

MR. BEEBE: Motive, really.

THE COURT: -- what the exchange does in the face of this kind of an article there should be some summarizing of its direction.

MR. BROOKS: Why don't we first establish whether it did anything differently. I don't see this is connected to the plaintiffs' case at all. You pointed out, when we were

talking about July, the people had their money in prior to January. It is almost a year now. What possible relevance to the plaintiffs' case can this article have other than to prejudice the exchange before the jury?

MR. BEEBE: I thought I explained that very fully. This is exactly the end, the capstone, that puts into context, or starts to put into context, exactly what it was the exchange wasn't doing, why wasn't it doing it. Someone had to put a stick of dynamite under them to get them finally to do what they should have done months ago. There was no real difference in the condition of McDonnell & Company at that point of time which would suddenly make the exchange go through with what it did. As Mr. Brooks well knows, the next thing that happened was they were knocked out of the box by the exchange.

THE COURT: I will tell you what I am going to do. I will let you go ahead and ask this man what, if anything, they did after this article appeared, without going at all into what the article contains. Then I will see whether we can't move crabwise into this kind of statement as to what it contains. It may not be necessary to get to that.

As I remember the pre-trial submissions, didn't this company go out of business in seven days after this article.

MR. BEEBE: A couple of months.

MR. BROOKS: In March.

MR. BEEBE: On Friday the 13th.

MR. BROOKS: What do you make of that, Mr. Beebe?

THE COURT: So that is six or seven weeks later.

MR. BEEBE: The SEC immediately filed a complaint.

THE COURT: Is there any contention the exchange did or did not do anything that had any effect on your client?

MR. BEEBE: They finally put him out of business, as they should have.

THE COURT: Suppose they had put him out of business on the 22nd of January, 1970. Would that have had an effect on your client?

MR. BEEBE: My point is not that they should have in December or January or February or some time like that in 1970 put them out of business. My contention is they should have regulated them before. My question is, why didn't they? What got them to do what they finally should have done?

THE COURT: I am grappling here with the proffer of Exhibit 69, and/or some narrative reduction.

It seems to me that even a narrative reduction of it would be-- and you are doing a balancing job here. It seems to me even that might be inappropriate if there is

no legal contention that anything flows from this article appearing in print.

MR. BEEBE: Something does flow directly.

THE COURT: What?

MR. BEEBE: The exchange, as we will show from the charging letter, the SEC complaint, and everything that happened started to happen within days after this. The exchange finally did what it was supposed to do only because outside pressure. It did not do it before.

THE COURT: But that doesn't affect your client's recovery one way or the other, because that depends upon things that you say they should have done earlier.

MR. BEEBE: That's correct, and that is exactly--

THE COURT: Therefore, what difference does it make as a matter of law or this record whether or not they did anything after January 23rd?

MR. BEEBE: Because,sir, and this is important because it goes on to what I am going to be showing in the next few days, the question I am sure in the jury's mind, and in many minds, when confronted with eviden like this, is why didn't the exchange act earlier? This begins to answer that question. Why didn't the exchange act in January, 1969.

THE COURT: The more I hear the more troubled

I am with putting in anything about this article at all as to its contents or the nature of its contents, but ask him what happened after this without getting into what the article contains. You cansay "There was an article, and did anything happen after that?"

MR. BEEBE: I will start along that line. I am worried in their case they are going to spend a great deal of time, unless they are blocked now, in putting in questions as to why they did this after January, 1969.

THE COURT: If the door is opened by something they bring in then it is opened and we will deal with it at the time. At this point I am going to exclude '69 or any representation as to it, and let's see what the proor shows.

MR. BEEBE: Yes, sir.

(End of discussion at the side bar.)

(In open court.)

BY MR. BEEBE:

Q After this article appeared, sir, did you take any steps at the exchange concerning McDonnell & Company?

A I don't recall.

Q Do you recall if anyone else at the exchange, any department or division, took any steps concerning McDonnell & Company after the publication of that article?

A I don't recall, no.

Q Did you know as of that time that McDonnell & Co. was in violation of Rule 325?

MR. BROOKS: Object to the question.

THE COURT: Sustained as to form.

Q Was McDonnell & Co. in violation of Rule 325 as of that time?

A I don't recall.

Q Let me read to you from page 283 of your deposition, starting at line 11:

"But you did have knowledge of violations of Rule 325; is that not correct?

"A Yes.

"Q Which we have reviewed over this two-day period?

"A Right."

Was that correct when you testified that way?

A Yes.

THE COURT: Is that in any time frame?

MR. BROOKS: No, it is not. The two-day period refers to the period that Mr. Newman was deposed.

THE COURT: Is the question itself in any time frame?

MR. BEEBE: Perhaps the witness can clarify it for us.

Q What time frame are you talking about in answer to that question?

A I don't recall what time frame it was.

Q Did the SEC file a complaint against McDonald & Company shortly after that article?

A I don't remember whether the SEC did or not.

Q Do you recall that they filed a complaint?

A I don't rememer at this point, no, sir.

Q Did the New York Stock Exchange bring charges against McDonnell & Company after that article?

A I don't recall the time, but the exchange did.

Q And did the exchange liquidate McDonnell & Company on or about March 13, 1970?

A Time means nothing to me, sir. I don't recall.

Q Leaving out the time frame, did the exchange liquidate McDonnell & Company at some point in early 1970?

MR. BROOKS: I object to the form of the question, your Honor.

THE COURT: Yes, sustained.

Q Do you know if McDonnell & Company was liquidated, sir?

A Yes.

Q Who liquidated it?

A I don't recall.

MR. BEEVE: No further questions of this witness on direct.

CROSS EXAMINATION

BY MR. BROOKS:

Q Mr. Newman, when you were in the Finance Division, was that before April, 1969?

A Yes.

Q You were head of that division, were you not?

A That's correct.

Q How many member firms were under your jurisdiction as head of the Finance Division for the particular affairs which the Finance Division was responsible?

A The entire membership.

Q And --

A Plus certain individual members.

Q When you became a coordinator in and about April,

how many firms were under your jurisdiction?

A Approximately 110, 112.

Q And I take it while you were in the Finance Division McDonnell & Co. was one of the firms under your jurisdiction?

A Yes.

Q When you became a coordinator they were under your jurisdiction?

A Yes.

Q Itake it the job was a little different when you were Finance Division chairman and when you were a coordinator?

A Yes.

Q Regardless of that, sir,atany time when you were either in the Finance Division or a coordinator, did you receive any instruction, oral or in writing, to treat McDonnell any differently than you treated any other member firm under your jurisdiction?

A No, sir.

MR. BROOKS: Do we have Exhibit 55 up there?

MR. BEEBE: What is 55?

THE COURT: What is 55, Mr. Brooks?

MR. BROOKS: Memorandum about a discussion with Mr. Barton of the SEC.

MRS. LICHSTEIN: Here is another copy of it.

MR. BROOKS: I have a copy of it.

THE COURT: Why don't you give him the copy.

Q Here is a copy of Exhibit 55, Mr. Newman. Do you recall Mr. Beebe discussed that exhibit with you yesterday and asked you if yourecalled your discussion with Mr. Barton? I believe that's reflected down at the bottom and up at the top of page -- of the next page. It say there, "Mr. Barton mentioned that he thought he might send an SEC examiner in, and I told him it was my understanding that SEC examiners had been in the firm recently, which he said was correct, but that he understood they were only looking into Regulation T area."

Do you have any recollection, and this is about April 28th, which is the date of the memo, do you have any recollection of whether Mr. Barton did send and SEC examiner into McDonnell on or about April 29th or 30th, 1969?

A No, sir, I don't recall.

Q Let me show you a note that I have pre-marked as Stock Exchange Exhibit SS for identification, and ask you if that note refreshes your recollection.

A Yes, it does.

Q And what is your recollection now about whether Mr. Barton sent an SEC examiner in at that time?

A That an SEC examiner went into the firm on April 29th.

Q Is this your signature on the note?

A Yes, it is.

Q And is that message in substance written on that note in your handwriting?

A Yes, it is.

MR. BROOKS: I offer SS as the exchange's exhibit in evidence.

MR. BEEBE: I object unless two things are established: one, that this was previously produced. It does not bear a marking on it. And two, that it appears to be a routing slip which says "For your information, return to me."

I would like very much to see the attachments to that.

MR. BROOKS: Your Honor, on the question of whether it was previously produced, in 1971 or '72, Mr. Beebe's law firm asked the stock exchange to produce a whole slew of categories of documents in respect to McDonnell & Company. The request was so broad that we produced the entire file of McDonnell & Company at the stock exchange. That included the SOQ file, the financial questionnaire file and a whole bunch of other files.

As you can see from the upper left of this exhibit it is part of the SOQ file. Mr. Beebe's predecessor at his law firm, elected to copy certain of those documents and elected not to copy other of those documents. Based on my knowledge of the facts this was made available to Mr. Beebe's law firm in 1971 or 1972. I don't know whether he copied it or whether he didn't.

MR. BEEBE: That takes care of the first part. It could have been done a little quicker, I think, because I will take Mr. Brooks' reprsentation without any problem on that score. But I don't see the attachment.

MR. BROOKS: Your Honor, I don't see that there is an attachment. There is nothing on this document that suggests there is an attachment.

THE COURT: You may ask about that on redirect examination, and I will permit the Exhibit SS to go into evidence.

(Defendant Stock Exchange Exhibit SS is received in evidence)

Q Mr. Newman, do you have any recollection in and about this time of the SEC instituting a regular periodic method whereby they could keep informed on the affairs of McDonnell & Co.?

A No, sir, I don't recall.

Q Let me show you another letter which I have pre-marked as Exhibit 44 for identification from Mr. McKay to Mr. Barton of the SEC and I ask you if that refreshes your recollection on that question.

Does that letter in any way refresh your recollection, sir?

A Yes, it does.

Q Can you tell me what your recollection now is?

A That McDonnell & Company was informing the Securities and Exchange Commission, furnishing it with estimated capital positions.

MR. BEEBE: If the witness is just reading from the document, it speaks for itself, unless that is independent recollection.

THE COURT: I gathered we were getting the witness' recollection as refreshed.

MR. BROOKS: That's what I asked him.

THE COURT: Let's be sure that is so.

Read the question back, please.

(Question read.)

MR. BEEBE: I stood up because he appeared to be reading, sir.

THE COURT: I know.

A It refreshes my recollection.

THE COURT: What is that recollection?

THE WITNESS: That the firm of McDonnell & Company would be furnishing the SEC with information.

Q What information, sir, do you recall it?

A I don't recall at this time. I would have to refer --

Q You have no independent recollection?

A No, sir.

Q Have you read the exhibit?

A Yes, I have.

Q Do you recall whether the furnishing of the recollection was to be on any regular periodic basis?

A No, I don't recall.

Q Does reading the exhibit in any way refresh your recollection?

A Yes, it does.

Q Can you now tell me what your recollection is as refreshed?

A That McDonnell & Company would furnish the SEC with capital information on a weekly basis.

Q Do you recall having seen this letter or received this letter at or about the time it is dated, April 29, 1969?

A No, sir, I don't recall.

MR. BEEBE: That can't be 44, that exhibit.

MR. BROOKS: 44 is the deposition number. Didn't I premark it?

It must be QQ.

MS. LICHSTEIN: It should be TT.

(Pause)

MS. LICHSTEIN: It is UU.

(Defendants' Exhibit UU was marked for identification)

Q I will move on for a minute, Mr. Newman, to another topic and we will return to this one from time to time.

Do you recall yesterday Mr. Beebe asked you whether a consequence of brokerage firms selling its branch offices was to reduce its assets? I believe you answered no, that it was not to use its assets.

A Would you repeat it?

Q As I recall a question Mr. Beebe addressed you yesterday, he asked you whether a consequence of a brokerage firm's selling off branch offices was to reduce its assets. I recall your answer being no.

Let me ask you the converse. Is a consequence of a brokerage firm selling its branch offices to reduce its liabilities?

A No.

Q What happens to the long-term leaseor to the lease that the brokerage firm has for its branch office

when the branch office is sold?

MR. BEEBE: Objection. I don't know if this witness is the right man for these questions.

THE COURT: Overruled.

A The lease continues on and payments would be made.

Q When abranch office is sold, does the lease get sold with it to the purchaser of the branch office?

A Normally.

Q And thent he lease would become the obligation of the purchaser?

A That's correct.

Q Would that reduce the aggregate indebtedness of the selling brokerage firm?

A I don't recall. I don't know really whether it would or not.

Q Would the selling brokerage firm receive cash or other consideration from the buying brokerage firm when it sold the branch office?

A Yes, it would.

Q That would then increase its assets, would it not?

A Correct.

Q Does the selling brokerage firm reduce its need for net capital under exchange rule 325 when it sells a branch office?

A I don't recall whether it would in case of a firm that carried accounts.

Q Do you recall the discussion that you had with Mr. Beebe a couple of times throughout your direct testimony about the liquidation of propriety positions?

A I don't recall any specific discussions.

Q As I recall it, the question Mr. Beebe asked you yesterday in reference to Exhibit 27 --

A I beg your pardon. I thought you referred to Mr. Barton.

Q No, Mr. Beebe. Let me show you again Exhibit 27. That's that June 25, 1969 memo that we have established that you wrote. Do you remember on page 3 Mr. Beebe inquired about the second paragraph which read, in essence, that to improve their capital the firm was going to liquidate some proprietary positions?

A Yes.

Q I'd like to get this explained a little bit better for the jury, Mr. Newman. What's a proprietary position of a brokerage firm?

A It's a position that is owned by the firm itself, the property of the firm.

Q Would an example of a proprietary position be 100 shares of AT&T that the firm of McDonnell & Company went out and purchased and held in its own name?

A Yes.

Q And --

A For its own account.

Q They own it?

A Correct.

Q If it goes up they benefit, if it goes down they lose.

A Correct.

Q And was it common for brokerage firms to take positions in their own name in certain securities from time to time?

A Yes,sir.

Q And when they did that, let's say they spend $1000 to buy some shares of ATT in their own name, could they get a full $1000 in capital credit under the net capital rule?

A I don't knowwhat the rule reads today, but at that time no, they could not get the full credit.

Q How much would they get?

A On common stock like American Telephone they would only be allowed 70 per cent of the market value or $700.

Q For that $1000 holding they are only getting $700 in net capital?

A Yes.

Q What do you mean when you say liquidate this proprietary position that we are talking about?

A You sell it out of your inventory, turn it into cash.

Q Sell that $1000 of ATT?

A Right.

Q And then when you sell it, I take it you get cash; right?

A Correct.

Q How much capital credit do you get for the $1000 in cash?

A Full value. $1000.

Q Is that what is going on here, when these memos talk about liquidating proprietary positions?

A Yes, it is.

Q Nothing to do with liquidating the brokerage firm of McDonnell & Company, is it?

A No, no.

Q Mr. Newman, let me show you Exhibits GG and HH, which were marked yesterday during the testimony of Mr. Schuette. Those are dated in early April, 1969. Here are copies of them, sir. They arenot the original exhibits. They are among the missing for the moment.

This first was a memorandum -- GG was a memorandum from Mr. Stock to Mr. Schuette asking him to draft a letter about a work plan, and the next page there are a few items that Mr. Schuette testified that he was going to put in the work plan. The pages after that are the letter that Mr. Schuette drafted for Mr. Stock about the work plan, and Mr. Schuette testified that letter was sent to McDonnell & Company.

Did you have any role in drafting either the work plan or the letter?

A Not that I can recall, no, sir.

Q Do you see your initials anywhere on the bottom left of the letter, as we have noted as being your custom when you prepared or help prepare a letter?

A No, sir.

Q There was a reply that Mr. Schuette identified for us yesterday, which is Exhibit HH, that T. Murray McDonnell wrote, we will get the plan the way you want.

That does show a copy was sent to you by Mr. McDonnell, does it not, sir?

A Yes, sir.

Q Do you recall this work plan discussion and exchange of letters in April '69?

A Not at this point, no, sir.

Q Do you know whether the work plan ever came in?

A I don't recall.

Q Let me show you a letter dated April 22, 1969, addressed to Fred Stock from Thomas McKay with a copy to yourself. I have pre-marked this as Exhibit TT.

I ask you if that refreshes your recollection as to whether McDonnell & Co. did submit the work plan as requested.

A (Reading) Yes, it does.

Q Is that the work plan?

A Yes, it is.

MR. BROOKS: I offer Exhibit TT in evidence, your Honor.

MR. BEEBE: No objection.

THE COURT: Received.

(Defendant Stock Exchange Exhibit TT was received in evidence)

Q Mr. Newman, do you recall at about this time discussions about McDonnell & Company's problems in counting their box?

A No, sir, I don't recall.

Q Do you recall that Lybrand Ross Brothers & Montgomery assisted in a box count at about this time?

A I don't remember, no, sir.

Q Will you take a look at the third page of Exhibit TT, which is the first page of Schedule A down there under "Additional steps," B-1, and tell me whether that refreshes your recollection on the assistance of Lybrand Ross in counting the box.

A Only from reading the schedule.

MR. BROOKS: May I read that short passage, your Honor?

THE COURT: You may.

MR. BROOKS: This is part of Schedule A of the work plan. It says "Additional steps. Lybrand Ross Brothers & Montgomery will make a complete count of all securities as of 4-24-69, from 4-24 to 4-27. One Lybrand employee has been retained to assist in investigation and correction of indicated differences. Personnel to assist in researching of differences has

been increased by three outside help."

THE COURT: Would this be as good a place as any to recess for lunch?

MR. BROOKS: It would.

THE COURT: We will do that.

2 o'clock, ladies and gentlemen.

(Luncheon recess)

rdh 1

AFTERNOON SESSION

2 P.M.

(In open court, jury present.)

G E O R G E H. N E W M A N, resumed.

MR. BROOKS: Your Honor, before we broke for lunch we had testimony by Mr. Newman that he recalled both the fact that McDonnell did submit a plan, a work plan as requested and that the SEC had requested that McDonnell & Company supply on a periodic basis directly to the SEC information about McDonnell & Co.

I have a series of documents which are in part such reports and I would propose to show those to the witness. They all indicate that copies were sent to the witness. Some of them bear his receipt stamp, some of them do not. I have pre-marked them and of course will ask the witness to identify these as documents that he has received.

THE COURT: Is there any question that they are McDonnell originated and that they are authentic?

MR. BEEBE: I just have had these handed to me, sir. There are seven of them, multi-paged. I would also object to the characterization of these being reports.

Assuming all of these things are true, which I don't know because I haven't had a chance go look at them, I have an objection as to relevancy.

Based upon the side bar conference I don't see what reports going into May, June, July and into September, 1969, concerning work plans relate to the issues.

THE COURT: If the only objection is going to be as to relevance, I would overrule that. If there is going to be an objection as to the competence or the authenticity, then that would be another matter.

MR. BROOKS: Perhaps I should offer them one by one if Mr. Beebe has a problem.

MR. BEEBE: I don't want to hold things up. I am not making an objection as to competence if Mr. Newman is only being asked whether he received these. I don't see that as something that is worth troubling over. Based on counsel's representation as to what he said they were, without looking through them, I won't rase any objection except for relevancy.

THE COURT: That objection is overruled. They may be received.

Read them off into the record and they will be marked in evidence as you read them off.

MR. BROOKS: The first one is a letter dated May 7, 1969, to Fred J. Stock from Thomas A. McKay pre-marked as New York Stock Exchange Exhibit VV.

The next one is a letter dated June 2, 1969, from

Thomas McKay to Fred Stock marked YY.

Let's fit WW between VV and YY, and that is a letter dated May 15, 1969, directly to Mr. Newman this time.from Thomas A. McKay, I believe.

The next one is a letter dated June 16, 1969, to Mr. Stock from Lawrence F. O'Brien pre-marked as ZZ.

The next one is a letter dated July 1, 1969, to Fred Stock from Harry Lindh pre-marked AAA.

The next one is a letter dated July 15, 1969. to Fred Stock from Harry Lindh pre-marked BBB.

The last one is a letter dated September 4, 1969, from Harry Lindh to Fred Stock.

THE COURT: To make the record clear, just mark out the ID marks on those and the said exhibits that Mr. Brooks just read off are received in evidence.

(Defendant Stock Exchange Exhibits VV, WW, YY,ZZ, AAA, BBB, CCC, are received in evidence.)

THE COURT: Mr. Brooks, do you want those yourself or do you want the witness to have them?

MR. BROOKS: The only purpose that I would have in having the witness look at them is to testify that each of them bears his name as an addressee on the cc or his date stamp or his initials.

THE COURT: They are in evidence I take it that is

apparent from the face of the exhibits.

MR. BROOKS: I will, if I may, represent that each of them has also a cc to Joseph Barton of the Securities Exchange Commission.

THE COURT: cc meaning a copy of each is sent.

MR. BROOKS: Right.

CROSS EXAMINATION CONTINUED

BY MR. BROOKS:

Q Mr. Newman, I show you a memorandum dated October 29, 1969, McDonnell & Company, over the initials GHN, which has been marked as DDD. I ask you if you were the author of that memorandum.

A Yes, I was.

MR. BROOKS: I offer that in evidence, your Honor.

MR. BEEBE: I don't believe this was marked at the deposition. May I have a moment to look at it?

THE COURT: Surely.

(Pause)

MR. BEEBE: I would object to the relevance of this.

MR. BROOKS: Your Honor, I have an extra copy. I am sorry I didn't furnish it to the court.

MR. BEEBE: We are in late October, 1969. Unless it is on the issue of liquidation.

MR. BROOKS: I don't see that issue discussed, your Honor, but it does relate to evidence--

THE COURT: We have put in evidence with this witness of things into January, 1970.

MR. BROOKS: Mr. Beebe put it in evidence all the way up to the end. We have discussed the reorganization both with Mrs. Murphy and Mr. James McDonnell. This memorandum relates to the reorganization.

THE COURT: Overruled. It will be received.

MR. BROOKS: I wonder if I may quickly read it, your Honor.

(Defendant Stock Exchange Exhibit DDD is received in evidence.)

(Defendant Stock Exchange Exhibit DDD read to the jury.)

MR. BROOKS: There is some handwriting which I can't make out and I don't offer it with the handwriting.

MR. BEEBE: Did we make a try at the handwriting?

THE COURT: If you want to read it on redirect, you may.

Q Now, Mr. Newman, the next document that I would like you to identify is an exhibit that I have pre-marked as EEE. It is a letter dated September 4, 1969, apparently signed by yourself to Mr. Fred Rosenberg of the Securities

Exchange Commission. I have retyped it because the best copy I had was very difficult to read. But the retyped copy, the real copy and the attachments are all in the package that I am marking.

My question, sir, is that your signature on the letter?

A There is no signature. I have initialed the copy of it. My initials.

Q Under the practice that you followed would that mean that you were the author of such a letter that was sent out?

A Yes, sir.

MR. BROOKS: I offer this as the next exhibit in evidence. That includes the attached enclosure which the letter describes as the report dated August 27, 1969, prepared by Mr.J.J. Senkowich, exchange examiner.

Q Can you identify that report as Mr. Senkowich's report?

A His signature is at the end of it on page 4.

MR. BEEBE: On the assumption that the retyped version is accurate, I have no objection.

THE COURT: Very good. It may be received.

(Defendant Stock Exchange Exhibit EEE received in evidence.)

Q Do you recall Mr. Senkowich's visit to McDonnell & Company during August of 1969?

A No, sir, I don't recall.

Q Would you look at the attached report which yousent to Fred Rosenberg of the SEC and tell me whether you can find any capital ratio in there reported by Mr. Senkowich which is below 2,000 per cent?

MR. BEEBE: Does the document speak for itself on that score?

MR. BROOKS: Your Honor, if Mr. Beebe would agree to that fact I don't need the witness to review it.

THE COURT: Well, I would think if it doesn't show it, you can argue that fact fromits face.

MR. BROOKS: All right.

A I see no ratio less than 2,000 per cent.

Q The next exhibit I would like you to look at, Mr. Newman, is a similar letter about a week later to Mr. Rosenberg of the SEC, signed by yourself, and is it in the same form, a retyped original. I do not have the attachment because I couldn't find it and I am not offering it with the attachment.

I ask you if that letter -- if you can tell whether that letter was signed and sent out by you on September 15th to Fred Rosenberg of the SEC?

A Yes, it was. It so indicates.

Q I offer it in evidence.

MR. BEEBE: I object on the ground of relevance to this September 15th covering letter without any enclosure in it. I just don't see what purpose is served at all.

MR. BROOKS: The purpose of the offer, your Honor, is to show that there was constant stream of information being furnished to the SEC by McDonnell & Company and the exchange.

(Defendant Stock Exchange Exhibit FFF is received in evidence.)

Q The letter says that it is enclosing a copy of the exchange analysis of the special financial questionnaire submitted by McDonnell & Co. as of July 31, 1969. Can you tell us what that analysis -- tell us who would prepare such an analysis?

A The Examiners Division.

Q Would it be prepared on the accountant's draft paper?

A Yes.

Q Would it be submitted to the coordinators?

A Yes, sir.

Q What would it show as a general matter?

A Well, the first part of it would show the capital

position of the firm as of July 31, 1969.

Q Would it contain any other information?

A It would contain other information, yes, sir.

Q In respect --

A Pertaining to the questionnaire.

MR. BROOKS: The next batch is similar to the first group that I offered. The first is that the addressee is Mr. Spies. In each case Mr. Newman and Mr. Barton of the SEC are designated as having received copies. They are sent by McDonnell & Company. I offer those for the same purpose as I offered the prior group, to show that the information --

THE COURT: Is there any objection? Aside from relevance.

MR. BEEBE: Aside from relevance, no, sir.

THE COURT: They may be received.

MR. BROOKS: They are pre-marked as Exhibits GGG and HHH.

(Defendant Stock Exchange Exhibits GGG and HHH are received in evidence.)

Q Mr. Newman, this morning you discussed with Mr. Beebe the subject of a knowledgeability letter. Do you know whether a knowledgeability letter was in 1969 required by any rule of the Stock Exchange?

A I don't recall that it was.

Q Do you recall your discussion with Mr. Beebe about whether lettered stock was eligible for capital treatment -- eligible as good capital?

A Yes, sir.

Q And I believe you stated that it was not?

A Correct.

Q Do you recall whether it could be under any particular circumstances?

A Not to my knowledge.

Q I would like to read to you to try to refresh your recollection testimony by Mr. McElroy given a few days ago in this trial to see if that refreshes your recollection on this question.

THE COURT: Show him the page and let him read it to himself.

MR. BROOKS: Yes. The page is 621 of Mr. McElroy's direct testimony. I have indicated in pencil the passage that I think is pertinent.

(Pause)

THE COURT: Now that you have read it does that refresh your recollection on that subject?

THE WITNESS: No, sir.

Q Mr. Newman, Exhibit 59, of which I have the copy,

was a memorandum prepared by you dated July 31, 1969, concerning a possible transaction between McDonnell & Co. and the firm of Scheinman, Hochstein & Trotta in respect to McDonnell's Management Company for their mutual fund.

There was a passage on page 2 which you wrote there referring to some additional letter which in the memo you recite you did not know about.

Do you see that there, sir?

A Yes, sir.

Q Do you know whether such an additiona letter ever arrived or turned up at the exchange?

A I don't recall, sir.

Q Do you recall the discussion you had with Mr. Beebe about arbitrage this morning?

A Yes.

Q You did recall there was a question about arbitrage in respect to McDonnell in 1968, did you not?

A Yes, sir.

Q Was that arbitrage in respect to rights that the subject-- that was the subject that arose?

A If I recall correctly, yes, it was.

Q Now, as I recall the discussion this morning, there was a question about how to treat arbitrage, now that

you have identified with respect to rights, for the purpose of whether it was or was not good capital; is that correct?

A Yes, sir.

Q Were there differing views on this question within the stock exchange staff?

A Yes, there were.

Q What camp were you in, sir? What position did you take?

A I guess I was in the opposition.

Q Who was on the other side?

A If I recall correctly, my then boss, Mr. Jones, was on the other side.

Q What position did he take?

A He thought that perhaps there might be some consideration allowed.

Q Was there considerable debate about this issue back and forth among the staff?

A Discussions, not necessarily debate.

Q One more question, Mr. Newman. The newspaper article that Mr. Beebe put in evidence this morning about McDonnell & Co. has in its last paragraph the following words.

"A number of other securities firms also have

indicated that they have run into financial difficulties because of a combination of sharply rising costs and a sharply declining stock market."

My question to you, sir, is did these factors of sharply rising costs and sharply declining stock market have effect on the member firms under your jurisdiction in about August of 1969?

A Yes, sir.

MR. BEEBE: Objection, relevance and lack of foundation.

MR. BROOKS: If it is not relevant, your Honor, why did the newspaper article go in.

MR. BEEBE: The rest of the newspaper article is very relevant.

MR. BROOKS: But Mr. Beebe read the entire article, including this paragraph.

MR. BEEBE: For completeness. I am willing to have it stricken if that's of some concern. I don't see this witness being the right man to ask something on whatever subject this is on.

THE COURT: Let me hear the last question read back, please.

(Question read.)

THE COURT: I will sustain the objection.

Q Mr. Newman, how would a sharply declining stock market adversely affect a brokerage firm such as McDonnell & Company?

MR. BEEBE: Objection. Lack of foundation for the witness to testify on this point.

THE COURT: I don't see there is sufficient foundation. Sustained.

Q Mr. Newman, you mentioned proprietary accounts before as securities being owned by a brokerage firm; is that correct?

A Yes, sir.

Q And these were assets of a brokerage firm, were they not?

A Yes, sir.

Q Would in the capital computation of a brokerage firm there were other security positions that might not necessarily be proprietary but yet were included on the plus or credit side of capital computations?

A I don't see how, no, sir.

Q Let's take a subordinated account like the plaintiffs had. As I understand the practice, a subordinated account would be a pledge of securities in an account; is that correct?

A Yes.

Q And that could be considered as part of the net capital of the firm while it was pledged?

A That would be considered a proprietary position.

Q That would be considered a proprietary?

A Since it was subordinated.

Q I take it there could be other proprietary positions that were not subordinated like the ATT shares we discussed? Just plain old owned by the firm.

A Yes.

Q Would a declining stock market lower the value of those subordinated assets and those proprietary assets so that there would be an adverse effect on the firm's net capital under Rule 325?

A Yes.

Q And what happens when the stock market prices go down to the volume of trading?

A To the volume of what?

Q Volume of trading, as a historical matter.

A Would you repeat that question, please?

Q What happens to the volume of trading when the prices of securities tumble?

A Historically, usually the volume of trading dries up a bit when securities tumble.

Q People get discouraged?

A Yes.

Q Now, if these two things are happening are they creating an adverse effect on the capital position of brokerage firms?

A Yes, they are.

Q Do you recall that these things were happening in the fall of 1969? By that I mean tumbling stock prices and drying up of the --

A Not particularly the fall of '69, but '68 and '69, the years in that period.

MR. BROOKS: I have no further questions.

THE COURT: Mr. Loflin, do you have any questions?

MR. LOFLIN: I have no questions, your Honor.

Q Was the stock market continuing to tumble in the 1970s, sir?

A To the best of my recollection it was.

Q The trend also continued as far as volume was concerned too, did it not?

A Yes, sir.

MR. BEEBE: Could I have a better copy from Exhibit BBB from somewhere?

MR. BROOKS: Is that triple D?

MR. BEEBE: Yes.

(Pause)

Q Let's go to the text of Exchange Exhibit DDD, which I hand you. There is a sentence in the fourth paragraph that starts, "The decision has been made to boil the firm down into a New York City company."

What is meant by "boil the firm down"?

A Reduce the activities.

Q And then --

A Reduce the activities of the branches, I would say.

Q Reduce the number of branches also?

A Yes, sir.

Q And then in the paragraph above that it refers to "The firm has practically been cut in half in

August and a loss of a million and a half in September, the possible loss of another million dollars in October."

Is it true that when you cut down the number of branches you cut down the revenues to the firm?

A Normally, yes.

Q And if your costs stay high, your losses go up?

A That is correct.

Q And when you have losses does that eat away your net capital?

A Yes.

Q Do you have Exhibit TT, sir, up there? That is double T. I believe that had reference to a plan.

Let me try asking the question without requiring the document in front of you. There was reference to a Lybrand-- a statement in a McDonnell report quoting Lybrand's statement that they were going to conduct a box count starting on April 24th, as I remember. Do you recall being questioned about that?

A Yes, sir.

Q Did they ever conduct that box count, do you know?

A I don't recall.

Q Sir, when did you leave your employment with

the stock exchange?

A On November 2, 1970.

Q Did you ever engage in any discussions with exchange officials concerning the demise of McDonnell & Company after it went out of business?

A I don't recall.

MR. BEEBE: No further redirect, sir.

THE COURT: Anything further. Mr. Brooks?

MR. BROOKS: No, your Honor.

THE COURT: Thank you very much. You are excused.

(Witness excused.

MR. BEEBE: I would like to call Mr. Richard A. Greves.

R I C H A R D G R E V E S , called as a witness by the plaintiffs, being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BEEBE:

Q Mr. Greves, are you employed by the New York Stock Exchange?

A Yes, I am.

Q And when were you first employed by the exchange?

A In 1960.

Q What was your position then?

A I was employed as a registration assistant.

Q And did there come a time when you became a finance specialist, sir?

A Yes.

Q Was that in 1966?

A Approximately, yes.

Q And then did you become an assistant coordinator from 1967 to about December 1968?

A No, I don't believe so. I think I became an assistant coordinator sometime in 1969 or the latter part of 1968.

Q What is your current position, sir?

A I'm an assistant vice president.

Q Is that in one of the departments of the exchange?

A Yes, it is.

Q Is that in the department of member firms?

A The department of member firms is no longer in existence. It's now called the regulations surveillance group.

Q When did that change take place?

A When the exchange was reorganized approximately two years ago, I guess it was.

Q Are the functions performed by the regulation and surveillance group the same functions that were performed previously by the department of member firms?

A Generally speaking, yes.

Q Now, in 1968, say starting in May, what was your position? What were you doing?

A In 1968, I guess I was still a finance specialist.

Q And what did that entail as far as survillance of member firms is concerned?

A Well, there was a group of us that were finance specialists. I guess there were five or six of us. Our primary responsibilities were to take the analysis that was done by the exchange examiners. That analysis would show maybe discrepancies in responses to financial questionnaires, certain areas that might have been reported inaccurately, and we would then communicate that information to the member organizations and ask them whether or not they in fact understood that it was an inaccuracy or ask for their explanation of why it was reported the way it was.

Q If the explanation was unsatisfactory or the inaccuracy -- the problem you found was great, what did you do with that fa ct?

A If the inaccuracy was great, in most cases I would take it to my manager even befoer I communicated with the member organization.

Q Were you also a recipient of information concerning the firm's net capital position?

A Well, the response to the joint regulatory report, the capital computation was computed based on the information contained in the financial report.

Q I take it the answer is yes, you were involved in that area.

A Yes.

Q If the information furnished upon analysis indicated a violation of the net capital rule, what did you do?

A I would call it to my manager's attention.

Q Were you also, when you were a finance specialist -- were you also in the documents division at one point?

A No. The documents division -- I was never in the documents division, no.

Q Did they report to you?

A No, it was a division like the finance division.

Q Was it also part of your duty as a finance specialist to be aware of when borrowings from a member firm expired?

A There was records that were maintained by the finance division as to the maturity date of the capital borrowings, yes.

Q And would your division be notified in some manner when the maturity date was coming up for these borrowings?

A Yes. We had a system whereby most of them were for six months duration and we would have a pending file that would indicate to us -- it would come out of the pending file and indicate to us that the borrowing was about to expire and we would send a letter to the firm.

THE COURT: Borrowings included debentures, did it not?

A No. That was not handled by the finance division. Debentures were handled by the documents division.

Q Was there also a system to keep you informed as to when a debenture came due?

A I'm not absolutely sure since Iwas not in that division. I think there was some kind of a pending file. But the debenture borrowings were for a longer period of time than the capital borrowings.

Q Sir, I just have some housekeeping documents here. I show you two documents and ask if they were addressed to you.

I guess we should mark them for identification.

(Plaintiffs' Exhibits 68 and 70 were marked for identification)

Q Sir, was it part of the normal procedure for a firm that is requesting an extension on an audit to submit a letter to you when you were at the Division of Finance requesting the extension?

A Yes, we did receive such letters.

MR. BROOKS: Your Honor, at this time I am going to object to this inquiry. In practice that we have already established, and I suspect to inquiry going to late 1967 and early '68 to extensions to the audit, which has never been brought into question in this proceeding.

MR. BEEBE: The extensions are what is relevant. That's why I am not introducing the audit. It is the extensions that matter. Particularly the handwritten notes on the bottom left of these two documents.

THE COURT: Come around to the side bar.

(At the side bar.)

THE COURT: What are these being offered for, Mr. Beebe?

MR. BEEBE: I'm afraid it takes longer here than I planned to spend on it. It was simply to show when they got delay requests the next year -- they being the stock exchange -- the stock exchange well knew there had been delays the prior year. The audit in the prior year led to violations which came out when the audit came in and

the imposition of restrictions. So the exchange was on notice in the end of 1968 that McDonnell was not a newcomer as far as the violations were concerned. They already had a track record, that was quite bad. This goes to that point. It is not an enormous point but it is raising that very notice provision.

MR. BROOKS: It doesn't show anything about violations. This just shows they were late in getting the audit from the auditors. If he wants to show violations he should put the audit in.

MR. BEEBE: If we like we can put the audit in. It is a lot thicker.

If I don't prevail on that argument, I think that's my problem, with all due deference, Mr. Brooks.

MR. BROOKS: If you want to show violations you have to go much further than this. It doesn't help you show violations.

MR. BEEBE: I'm not trying to show violations, I am trying to show a record of delays which led in turn to violations.

THE COURT: It seems to me this is irrelevant.

MR. BEEBE: It is relevant to notice point, sir.

THE COURT: What notice point?

MR. BEEBE: That in 1968, a year later when the

audit came up, again there were delays and the delays were not minor. As I think was tried to be brought out and I am trying to meet the point, this was not a customary delay. This was something that actually had a history of delays which were followed by findings of violation. So there is a notice record. I think it is very relevant.

THE COURT: It seems to me if you are going to get into that I have two observations: one, it seems to me this cuts against your case instead of in favor of it because that delay in one year, there wasn't a sufficient problem on which to do anything. That delay in itself is evidence of nothing.

On the other hand, it seems to me if you open the door to this you then have to get into, to put it into perspective, you have to find out how many other firms were involved in asking for delays on their audits.

MR. BEEBE: The first part of that, sir, is exactly the point I am making. After the delay there were violations. It didn't lead to nothing, it led to something, the imposition of restrictions, the only time they were imposed. The restrictions were back in April, 1968. They saw the audit and they imposed the restrictions, as perhaps was the proper treatment at that point. But they didn't do it the next time around.

I have another point I would like to make after this.

THE COURT: Well, I'm going to overrule the objection.

MR. BEEBE: May I make my other point briefly, sir, while we are here?

THE COURT: Yes.

MR. BEEBE: Throughout thistrial Mr. Bishop has been sitting over on the side on the left observing things after our initial question I raised about that. He has now shifted to directly behind me. The man on the stand works, I believe, in either Mr. Bishop's department or he is on top there. I would feel much more comfortable if he weren't looking over my shoulder as boss. I don't think that is an untoward request.

THE COURT: While I don't see anything sinister to where he is sitting, would you ask him to move over?

MR. BROOKS: Yes. I think he had trouble hearing because of the noise over there, your Honor.

THE COURT: That may be.

(In open court.)

MR. BROOKS: Did you want me to follow that instruction immediately, your Honor?

THE COURT: Yes.

MR. BEEBE: Was there an offer for these documents pending? I forget where we left off.

Could the reporter read it back for us.

(Last question and answer read.)

MR. BEEBE: Offer them in evidence.

MR. BROOKS: No objection.

(Defendant Stock Exchange Exhibits 68 and 70 received in evidence.)

THE COURT: I take it this is without the handwriting on the face of the documents?

MR. BROOKS: Yes. Unless Mr. Greves can identify them.

Q Turning to Exhibit 68, which is the September 27th letter, is that your handwriting on the bottom left?

A Yes.

Q Could you explain what those dates down there, I believe it says "first letter." What does it say?

A I don't know what the first one means, the 10-26R.

Q The next one says "Due 11/27." Does that refer to the date of when the 1967 audit was due from Lybrand?

A You know, I can only assume that. I have to see the other records to confirm that was the date.

Q Below that it says, "First, second and third," and has dates next to that 12/11, 12/26, 1/9/68. Could you

explain what those refer to?

A I think these are extension requests, but I would have to see what the other letters in the file said about extension requests, to confirm the actual dates. I assume that they are.

Q Could we turn to the next page--

MR. BROOKS: I move to strike it if it is based on an assumption.

THE COURT: Strike the assumption.

Q Turn to the next one, sir, and perhaps that would refresh your recollection. It again has a series of dates, "Due first, second and third," and then it has a fourth, 1/23. Then below that, "Okay to 2/6/68." Is that your signature and handwriting?

A Yes, it is.

Q Does that refer to extensions and does the "Okay to 2/6" refer to granting of the extensions?

A Yes.

Q Whose handwriting is on the right hand side of Exhibit 70, sir?

A I believe that's mine, sir. It is my handwriting.

MR. BEEBE: I offer this for identification.

(Plaintiffs' Exhibit 71 is marked for identification.)

Q I ask you, after looking it over, if you recall receiving such letters in the ordinary course during your duties in the division of finance?

(Pause)

A Yes, we would receive that type of letter.

Q It's addressed to you?

A Yes.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 71 was received in evidence)

Q Sir, I direct your attention at the bottom of page 2 on the subject of arbitrage and its treatment for rule 325 purposes. The sentence at the bottom reads, "We maintain that arbitraged positions should be valued for capital purposes on a trade date basis, although this is not in accordance with rule 325," and it has some sub parts.

Do you recall McDonnell & Company requesting that arbitrage positions be valued for capital positions on a trade date basis?

A Not independent of this letter I don't recall it.

Q Let me show you another memo.

MR. BEEBE: Mark this for identification.

(Plaintiffs' Exhibit 72 was marked for identification)

Q Is that a memorandum from yourself and signed by yourself to Mr. Newman dated September 3, 1968?

A Yes, it is.

Q On the subject of arbitrage and McDonnell & Company; is that right? I direct your attention to the first paragraph.

A The subject is McDonnell Company and the first paragraph mentions arbitrage, yes.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 72 was received in evidence).

Q Does looking at the second memorandum refresh your recollection as to the question of arbitrage and McDonnell & Company as of that time?

A No, I'm afraid not.

Q I will go to a different subject, sir. On the question of knowledgeability letters, were you familiar

with the use of knowledgeability letters?

A Yes.

Q Who was responsible in 1969 for the decision of whether or not to request a knowledgeability letter?

A I believe it was the officers of the exchange.

Q Would that include the finance specialists?

A No.

Q If I could read from your deposition, sir, given on April 17, 1973, and ask you if this was your testimony, page 43:

"Q Do you recall whose duty it was at the New York Stock Exchange to see that knowledgeability letters were provided by capital contributors?

"A If the firm was put on that 'form of restriction' it would be the duty of the finance specialist."

Was thatyour answer under oath at the time your deposition was taken, sir?

A Yes, that is my answer. If I might explain.

Q Certainly, sir.

A I think your original question was who made the decision as to whethrer or not a firm was required to file a knowledgeability letter. The officers of the

exchange made the decision as to who was required to file the knowledgeability letters, but the finance specialists were the ones who received them from the firms.

Q Do you know on what basis a decision was made as to whether or not to require knowledgeability letters?

MR. BROOKS: Is that an inquiry into the general practice of the exchange? If it is, I would like a date attached.

MR. BEEBE: 1968, 1969.

A I think it was in consultation with the officers who were in charge at the time.

Q What was the basis of their decision when they decided to require knowledgeability letters on the capital of the firm?

THE COURT: I sustain the objection to the form.

You are talking about the criteria that were applied, not the basis of any particular decision, if I understand you correctly; is that right?

MR. BEEBE: That is right.

MR. BROOKS: I also would object on the ground there is not a foundation for Mr. Greves to tell us what the criteria were that the officers applied,

unless he was an officer or he knew of that criteria independently.

THE COURT: I would assume Mr. Greves would not give us an answer unless he had a basis for it.

MR. BEEBE: I am always making that assumption, sir, when asking questions.

THE WITNESS: It would depend on the circumstances in the firm. I wasn't privy to the officers' decisions. I wasn't at the meetings.

Q Do you know any circumstances that came to bear in the decision.

A For McDonnell & Company?

Q I mean in general, sir.

THE COURT: I think that's irrelevant. Sustained.

Q Do you know in the case of McDonnell & Company what criteria were applied in deciding whether or not to request knowledgeability letters?

A No.

Q Who was the finance specialist for McDonnell & Company in 1969?

A I'm not sure who my replacement was.

Q Would the name Robert Spies assist you?

A Yes. I believe he became the assistant

manager and he might have had responsibility for McDonnell & Company.

Q Sir, I have another housekeeping matter, sir. I would like to show you a document dated August 20, 1968, and ask you if that was the kind of document or letter you would normally send to McDonnell & Company in the course of your duties in the division of finance?

Mark that one for identification the next plaintiffs' number.

(Plaintiffs' Exhibit 73 was marked for identification)

A Yes, this is the type of letter we would send to McDonnell & Company.

Q And that is over your typed signature at the bottom?

A Yes.

Q Is that your signature also on the front page, R. Greves?

A Yes.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 73 was received in evidence)

Q Do you recall seeing, either from the various exhibits you have looked at this afternoon or just your own independent recollection, anything more concerning the arbitrage controversy with McDonnell & Company in late 1968, the outdome of it?

A No, I'm afraid not.

MR. BEEBE: No further questions on direct of this witness.

THE COURT: Why don't we take our mid-afternoon recess at this point.

(Recess)

(In open court; jury present)

CROSS-EXAMINATION

BY MR. BROOKS:

Q Mr. Greves, you testified on direct that at one time one of your functions was to notice when debentures matured. Is that correct?

A Yes.

Q And at what time was that your function, sir?

A When I was a finance specialist. It was on the basis of the response to the financial questionnaire there would be an indication of that. The document division handled the debentures.

Q Is there a financial questionnaire -- let me show you Exhibit S thathas been marked before entitled "Answers to financial questionnaire." Is that what you are talking about?

A There is an analysis of that prepared by the examiners, and they attach sheets that show the various capital borrowings and debentures that are outstanding, and that are going to expire, that are reported by the auditors.

Q If the auditors reported the following -- and I am going to read some language to you from

page I-10. I am going to read some language from a note as to McDonnell & Company, and then discuss questions. Pay attention to the reading.

"On December 31, 1968, series A and series B registered subordinated debentures were retired except for an amount of $80,000 redeemed for cash. Such debentures were exchanged for a new issue of debentures, series E, maturing December 31, 1978. On January 8, 1979, an additional $50,000 of series E debentures were issued. Series B debentures bear interest at per annum rate of 2 per cent in excess of the prime rate being charged by the First National City Bank."

My question, sir, is if that were contained in an audit or financial questionnaire that reached your domain at this time would you be concerned about the maturity date either of the B debentures or of the E debentures?

MR. BEEBE: Objection. Hypothetical. Beyond the scope of the direct. And I think no connection with this witness as having that kind of involvement with this kind of transaction.

MR. BROOKS: The reason I asked the question is Mr. Beebe asked whether or not Mr. Greves kept track of the maturity dates of the debentures, and I suspect the

reason he did that was to lay a foundation to say Mr. Greves should have been keeping track of the Series B debentures maturing on such and such a date.

THE COURT: I appreciate that, but I am not sure the question will get out what you want to get out.

Q Mr. Greves, let me show you what I read, and ask you if you had read that note or if that note had been reported to the examiners who were reporting to you, would there appear in the reports that reached you anything at all about the maturity date of the Series B debentures?

A No, I doubt it very much.

Q Why do you doubt it?

A Because the accountant has reported that it's been renewed.

Q So it's a debenture that is not maturing?

A That is correct.

Q We looked at two letters directed to your attention a little while ago, Exhibits 68 and 70. Do you have those, sir?

A Yes.

Q Both these letters were asking for an extension in the timer in which Lybrand, Ross Brothers & Montgomery had to file their audit report for the

year 1967.

My question to you, sir, is: Toward the tail end of 1967, and 1968, were such requests for extension common from the auditors of member firms of the New York Stock Exchange?

A Yes, they were.

Q Do you know what caused the number of requests for such extensions at about this time?

A The securities industry was having difficult times because of thelarge number of transactions that were being executed.

MR. BROOKS: I would like to read, your Honor, one paragraph that is in each of these. It says:

"Meanwhile, we are meeting capital requirements in accordance with rule 325."

Q Was that paragraph a common paragraph that appeared in such letters requesting extensions for the auditors to file their report?

A Yes.

MR. BEEBE: Objection to relevancy.

THE COURT: No. On that ground, overruled.

Q You may answer.

THE COURT: He said "Yes."

A Yes.

Q Was this a requirement of the exchange, that there be requests for such extensions?

A Yes.

Q I have one more short question, Mr. Greves:

In Exhibit 73, which Mr. Beebe identified through you and had entered into evidence, on the bottom of page 2 there is a paragraph which reads "The relationship of the debenture holders to your organization should be included as part of the details reported under part 2(a)(i). Would you keep this point in mind when preparing future questionnaire responses? "

My question to you is: What in plain, everyday language, are you telling McDonnell to do in the future?

MR. BEEBE: Objection as to relevancy.

THE COURT: Overruled.

A The exchange had a rule that certain parties who were making capital contributions to a member organization couldn't be paid above a certain level of interest.

However, if the party was a relative or, a father, son, brother, mother, in-law or something

like that, a higher rate of interest could be paid to those individuals that wouldn't be looked upon as a rebate of commission.

Q Were you asking in this language for that kind of relationship to be disclosed on future financial questionnaires filed by McDonnell & Company?

A Yes.

Q And was it for the purpose of making that judgment, whether they were getting too high an interest rate?

A Yes.

Q What's the philosophy, if you know, what's the philosophy -- strike that.

Do you know the philosophy for permitting mothers, sisters, brothers, of principals of the firm to get a higher interest rate than people who aren't mothers, sisters and brothers?

MR. BEEBE: Objection as to philosophy questions of this witness.

THE COURT: If he knows.

A It's really the reverse. It's the philosophy behind the others than insiders, so to speak, getting a higher interest rate, because until recently the exchange had a fixed rate of commissions

that could be paid to customers. A way around that fixed rate or getting away from the minimum commission, a firm could get a customer of another firm and say "I will pay you a very high rate of interest on the capital contributed to us" and therefore would be a rebate of the commission.

MR. BEEBE: Move to strike as not responsive to the question and goes beyond.

THE COURT: No, I think it explains the portion in this letter that is in evidence. Overruled.

Q Would a fair characterization of the purpose of this rule be that the rule tried to prevent one firm from -- by making a favorable --

THECOURT: I think this does get into the area of lack of relevance.

MR. BROOKS: I withdraw the question. No further questions of Mr. Greves.

REDIRECT EXAMINATION

BY MR. BEEBE:

Q You mentioned with regard to the last series of questions about the relationship of the debenture holder that this was aimed at eliciting information concerning some exchange rule permitting fathers and sons and others of that nature to get a different rate of interest than others, is that correct?

A That's correct.

Q Do you know of any other exchange rule that pertains to fathers and sons and people of that nature getting any different treatment?

A Other rule?

Q Yes. Other than the one you just mentioned, sir.

A Well, the rule that I am referring to is not this rule, in response to the questionnaire, it is Rule 325 of the New York Stock Exchange.

Q Does it set out any particular exception or treatment for fathers, sons, and people of that nature?

A It says insiders may be paid a higher rate of interest.

Q Does it say anything else that pertains to fathers and sons, if that's how you characterize people of that nature?

A Yes, I believe it does.

MR. BROOKS: I believe the rule is in evidence. Maybe Mr. Greves can point out the particular section, but I think since it is in evidence it speaks for itself.

MR. BEEBE: Since the subject was raised and allowed over objection I would like to explore a little further if there is any other.

THE COURT: If you are just going into the question of whether it exists in the rule then the rule is the best evidence. It is not a question of this gentleman's awareness of it.

Q Have you had any other experience, sir, with -- well, I will withdraw that.

You mentioned in regard to the requests for extensions in 1967 and early 1968 that a number of firms were asking for them at this time?

A Correct.

Q Or had asked for them?

A Yes.

Q How many extensions were requested, do you know?

A By this firm?

Q Yes; Exhibit 70 might refresh your recollection.

A It appears that the fourth -- four extensions plus the one on January 23rd, so five extensions were

requested.

Q Was that a little more than usual?

A It would be hard to say. I can tell you that there were a number of firms and auditors that were requesting extensions. The number of times on which the extensions were requested it is very difficult to say.

Q Would you say that firms that were having greater paper work problems were requesting more extensions?

A Yes.

Q Mr. Brooks asked you about the maturity date of debentures. I would like to ask you if you had learned about the maturity date of the debenture being December 31, 1968, if you learned about it beforehand from reports by the company, would you make any efforts to verify whether or not the instrument that was maturing was indeed paid?

MR. BROOKS: I object to the form of the question.

THE COURT: Sustained.

Q Did you make any efforts, sir, with regard to McDonnell & Company and the maturity of the debentures?

A I am not sure what the question is.

Q The question is, sir, did you in your experience as a finance specialist, in what you were doing at the end of 1968, make any effort to verify the authority for paying any debenture that matured on December 31, 1968?

A Not that I recall, no.

Q I believe you said that there were sheets that were prepared by the finance department that showed when capital expired?

A There are actual files. In each file was the document on capital borrowings. On the front of that file was the indication of the name of the person who was the lender, the name of the person who was borrowing money, and the maturing date was on the right-hand side.

Q Where were these maintained?

A In the finance division.

Q That was your division, right?

A Yes.

Q Could you describe for me what's contained in a file that involved the maturity of an instrument in the name of a trust?

A Was it a capital borrowing?

Q Yes, sir.

A A capital borrowing --

MR. BROOKS: Your Honor, I am not sure Mr. Noble and Mr. Greves are using the same terminology when they use terms like capital borrowing. I think that should be explored before the two of them start talking about it because it might lead to confusion.

Q I don't want to load any terms. You tell me, sir.

A There is a difference between a debenture and a capital borrowing.

Q Let's take debentures.

A Debentures I had nothing to do with. That was the document division. They had their own set of files.

Q That is Mr. Carr?

A That is Mr. Carr, yes.

Q Now, let's stick with capital borrowings, then, the area that you were involved in. What was in the folder on this particular instrument?

A On each borrowing by a member organization the borrowing was for the purposes of buying stock in a member organization or making a subordinated loan to a member organization. Within each document it also had to have some subsidiary documents attached to it.

Q Such as the authority for the people who were doing the borrowing?

A If it was a trust, yes.

Q That's what I am driving at.

A The trust agreement.

Q The trust agreement would be in there?

A In most cases I believe it was, yes.

Q Do you know if Mr. Carr's department operated in

the same way?

A No, I don't believe they did.

Q Do you know whether they had access to a trust agreement if a trust agreement was involved?

A I really can't say for sure.

Q Could you explain to the jury what you would look for in a trust agreement at the time a borrowing became due?

MR. BROOKS: I object on the grounds of relevance. We don't have a trust agreement that is at issue in this case.

THE COURT: Sustained.

MR. BEEBE: I think we do with a roll over.

THE COURT: That is not in his department.

MR. BEEBE: No further questions of this witness.

THE COURT: Mr. Brooks, anything further?

MR. BROOKS: Not by me, your Honor.

THE COURT: You are excused.

(Witness excused.)

MR. BEEBE: Mr. Spies.

R O B E R T A. S P I E S, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BEEBE:

Q Good afternoon, sir. Are you with the New York Stock Exchange now?

A Yes, I am.

Q Have you been employed with the document division? Did you begin employment with the document division about 16 or 17 years ago?

A About 22 years ago.

Q How long did you stay with the document division?

A I think I worked in that division about 14 years.

Q And thereafter did you go to the examiners division?

A Thereafter I went to the finance division first, and then I did spend about six months up in the examiners division.

Q Were you an assistant manager of the documents division between 1964 and 1970?

A I don't think it went up to 1970. I was assistant manager of the document division for a period of time, yes.

Q When did youleave that division, sir?

A I would say about 1966.

Q And where did you go then?

A Then I went to the finance division.

Q Were you both a finance specialist and the manager of the finance division?

A Yes, I was.

Q As part of your duties as assistant manager of the document division, were you responsible for reviewing the agreements and corporate papers of member firms to assure their compliance with the regulations of the New York Stock Exchange?

A Yes, I was.

Q When you were a finance specialist, which I think takes us into 1968, did your duties include responsibility for the regulation and maintenance of the capital structure and compliance of member organizations?

A That's correct.

Q Did you become the manager of the finance division in about the middle of 1969?

A I think it was around 1968, but in that area.

Q And was the finance division responsible for the compliance of member organizations with the capital rule?

A Yes, it was.

Q As manager of the finance division did you report directly to Fred Stock?

A I did for a time.

Q While you were a finance specialist in 1968 and

1969 -- we are focusing on those particular years, sir -- were you responsible for the MNOP group?

A Yes, I was.

Q During that period did you become familiar with McDonnell & Company?

A I handled that organization, yes.

Q When did you become the finance specialist responsible for the MNOP group?

A I would say around the latter part of 1968, when I moved out of the document division.

Q We were just asking your predecessor on the stand some questions about maintenance of documents in the document division. Maybe I can ask you. Did the document division, when you were there, keep track of the maturity dates of capital borrowings of member firms?

MR. BROOKS: I object on the grounds of relevancy, your Honor. The witness testified he moved out of the document division in 1968.

THE COURT: No, I think it was in 1966.

MR. BROOKS: Since he moved out in 1966, I don't think it is relevant to the facts in this case.

Q Didn't you say it was in the middle of 1968 you went to become a finance specialist and moved out of the document division?

A I think I moved out around 1966, when I became a finance specialist at that time. I think around 1968 I became manager of the finance division.

Q Do you know if the practices in the document division continued essentially unchanged from 1966 through 1968?

MR. BROOKS: Your Honor, I object. He wasn't a member of the group.

THE COURT: Do you want to address yourself to the particular thing you were talking about?

MR. BEEBE: I would like to.

THE COURT: Do that, and see whether he knows what the practice was and whether it continued.

Q Was there a practice when you were in the document division of keeping the different debenture borrowings--keeping track of the debenture borrowings?

A We kept a record of the debenture borrowings, yes.

Q And what did that record consist of?

A Mainly as to who were debenture holders in a member organization, and we had copies of the documents that they executed.

Q Did that also include the maturity date of the debentures?

A The maturity date would be stated in the documents

BEST COPY AVAILABLE

Q And when you say documents, would that include the trust instrument if a trust was involved?

A Yes, it would.

Q What was the purpose of keeping those documents at that time?

A Basically, to -- the trust instrument was kept basically to see if the trust had the power under the trust instrument to make such an investment in a member organization.

Q Did you review that when the trust instrument came up for maturity? Was that the procedure?

MR. BROOKS: I object to the question.

THE COURT: Overruled.

Q You may answer, sir.

MR. BROOKS: Your Honor, the question was when the trust instrument came up for renewal.

THE COURT: I thought it was for review, he said.

MR. BEEBE: On maturity, when the debenture matured, was the trust instrument reviewed to see if it was complied with.

THE COURT: Overruled.

Q You may answer, sir.

A No, not normaly. It would be reviewed at the time that the trust first became a debenture holder of the organization.

Q Are you familiar with roll overs, sir?

A I know what the term generally means.

Q The exchange of one debenture for another?

A Yes.

THE COURT: Mr. Beebe, I have given you much latitude. His testimony is that in 1966 there was a practice of looking at a trust instrument to make sure that it had the power to permit the debenture instrument to be executed. He says nothing about reviewing anything on maturity date. As a matter of fact, he said something to the contrary. All he said was he looked at the beginning to see if it was an authorized investor, if I remember it correctly.

MR. BEEBE: Can I approach it from a different way then?

Q When the debenture instrument matured what was the practice with regard to ascertaining whether or not it was paid?

MR. BROOKS: Your Honor, I am going to object.

THE COURT: If any.

Q If any.

MR. BROOKS: The witness left this division in 1966.

THE COURT: This is in 1966 that we are about.

MR. BROOKS: Then the answer can't be relevant to our facts.

MR. BEEBE: I hope to connect it in due course.

THE COURT: Let's see. Go ahead.

The question was what happens at the time it comes up to be paid. Do you keep track of it at that time, and do you do anything?

A The document division did not, no. It was up to the member organization basically.

THE COURT: Let's go on to another subject.

MR. BEEBE: Could I just try to connect that, then?

Q Do you know if there was any change in that practice between 1966 and 1969?

MR. BROOKS: Same objection.

THE COURT: Overruled. Do you know?

A I have no ideа.

THE COURT: Let's go on to another subject.

Q As financial specialist, sir, which you said you became -- I believe the manager of the finance division, was it?

A That's correct.

Q In late 1968, what documents normally flow to you?

A Normally, the finance division received what was

called a white sheet from the examiners division, which was a paper prepared by them based on an analysis of a financial questionnaire, and we also received copies of a visit report prepared by an examiner if and when they went into a member organization to review it.

Q Was there a card file maintained concerning capital violations when they were noted?

A The finance division kept a card record of all member organizations and the type of the business that they did. On the back of that we made a little notation if the organization violated the capital rule.

Q That was noted on the back of this card file when you were a finance specialist?

A Yes, it was.

Q Are you still with the finance division?

A No, I am not.

Q Was there a card file for McDonnell & Company?

A Yes.

Q Do you know what became of it after you left?

A No, I don't.

MR. BEEBE: I call for the production of that card file which is the subject of a subpoena.

MR. BROOKS: We have looked for it and can't find it.

Q Was it standard procedure for you to attend advisory committee meetings dealing with capital problems in 1968, 1969?

A If it was the desire of Fred Stock, yes, I did.

Q Could you explain for the jury what the advisory committee was?

A The advisory committee is a subcommittee of the at that time the Board of Governors, who sat in judgment on a memorandum that was prepared by the staff concerning charges or violations of rules and regulations of the exchange.

BEST COPY AVAILABLE

Q Who was on the advisory committee in April, 1969, as best as you can recall?

A I can't recall.

Q Could you recall any members of the advisory committee as of that point?

A No, I can't. It is a rotating committee-- it was a rotating committee.

Q Did it consist of members of the Board of Governors?

A Yes, it did.

Q The memo that was prepared by the staff, is that called a charging memo?

A That's what we used, yes.

Q In the course of your duties as manager of the finance division in charge of the MNOP group, was it part of your function to write to a member organization stating the exchange's analysis of the regular financial questionnaire submitted by the organization?

A Yes, we would prepare a letter.

Q I show you a letter dated February 7, 1969, addressed to McDonnell & Co., Inc., over your typed signature and ask you if that is such a letter?

A Yes, this would appear to be a copy of such a letter.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 74 received in evidence.)

Q Was it also part of your function in 1969 to notify a company when subordinated lenders had been approved by the Board of Governors?

A The exchange notified the company, not specifically the financial division.

Q I show you a letter dated March 17, 1969, and ask you -- it is addressed to McDonnell & Company, Inc., over what appears to be your signature. I ask you if that was your signature?

A Yes, that's my signature.

MR. BEEBE: I offer that.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 75 is received in evidence.)

Q The February 7th letter, sir.

I show you a copy of a document that previously had been marked in evidence. I will find the number in a minute for the record.

That is in evidence, isn't it?

MR. BROOKS: I think that's right.

Q Could you look that over for a minute, sir? I

want to ask you one or two questions about it.

(Reading)

MR. BEEBE: We have now found that it is number 26 in evidence.

(Pause)

THE COURT: Mr. Beebe, put a question.

Q Sir, have you had a chance to familiarize yourself a little bit with that short form examiner's report?

A Yes.

Q I direct your attention to the report itself, inside on the first page -- under the date of the report there is a note, "RAS, I would like to bring this 325 charge soon."

Is that Mr. Stock's initials underneath there?

A I believe it is, yes.

Q RAS was yourself?

A Yes.

Q And do you recall Mr. Stock instructing you with regard to bringing a 325 charge soon, pertaining to McDonnell & Company at that time?

A Not separate from the note that I read here.

Q On the top document which seems to be a note on Mr. Stock's stationery, "RAS, I will have GHN include 325 in memo with other charges." Again, is that Mr. Stock's initial

A Yes, I believe so.

Q You believe so?

A Yes.

Q Does that refresh your recollection somewhat as to whether there was a request at that time to bring 325 charges?

MR. BROOKS: I object because I think the date on the first document, Exhibit 26, is a different date. I'm not sure. I think we ought to find out.

MR. BEEBE: I'm just asking at the moment for refreshing the witness' recollection. The two dates obviously appear to be identical.

Q At that period of time, late in April, sir, 1969, do you recall the question of bringing charges against McDonnell & Company arising and you participating in the discussion?

A Not beyond what I read here.

Q Does this at least refresh your recollection that there was a discussion there?

A I don't know whether there was really a discussion or just a matter of notes going back and forth between us.

Q Was there a procedure when you were a finance specialist in 1969, whereby emergency treatment was given with respect to loans under Rule 325? Do you recall such

a procedure?

A Yes, there was, and a delegation of authority.

Q Could you explain that for the jury, what the occasion would be for invoking that procedure?

MR. BROOKS: Isn't this cumulative? Didn't one witness testify fully to this area?

MR. BEEBE: I'm not sure it was laid out with someone with knowledge. There may have been doubts--

THE COURT: Overruled.

A This was a procedure that if the exchange had all of the pertinent papers and the papers were acceptable with respect to the admission of a subordinated lender to a member organization, the exchange did have the -- the staff had the power to allow the firm to use the money as good capital before the posting period was completed and the final approval by the Board of Governors.

Q What is the normal posting period used for?

A At that time the posting period was two weeks and it was a matter of publication in the weekly bulletin alerting the industry as to what was going on in member firms.

Q And the emergency procedure suspended that; is that right?

A It didn't suspend it. It allowed the member firm to have the use of the capital to meet the capital

rule prior to the completion of that period.

Q I show you a document dated January 30, 1969, from McDonnell & Company to the department of member firms, and ask you if the reference in the last paragraph concerns such emergency approval with regard to McDonnell & Company?

(Plaintiffs' Exhibit 76 marked for identification.)

MR. BROOKS: I believe this is already in evidence. I think I offered it during my examination of Mr. Schuette, I think. But I don't object to it going in again.

THE COURT: Then there can be no objection to using it at this point with this witness.

MR. BROOKS: No, sir.

THE COURT: Go ahead, Mr. Beebe.

MR. BEEBE: If it is not in evidence -- I will ask the witness a question about it.

Q Was such emergency approval in effect as far as McDonnell & Company was concerned?

A This would appear to be relating to that authority that the exchange had, yes.

Q Was it the policy of the New York Stock Exchange to express concern to a member firm when its net capital ratio exceeded 1,500 per cent.

MR. BROOKS: I object again.

THE COURT: Sustained.

Q Sir, was that part of your duty to communicate with a member firm when the exchange had concern about the firm's capital position?

A Yes, it was.

Q And was 1,500 per cent the level at which you--

A That was the level that we used at that time, yes.

MR. BEEBE: No further questions on direct of this witness.

THE COURT: All right.

MR. BROOKS: I have a few questions, your Honor.

Q Mr. Spies, when you said that 1500 was a time that the stock exchange expressed concern to a member firm, you used the term "At that time." What do you mean by "At that time"?

A Well, I think today and subsequent to that time with the ratio change of the rules, this ratio guideline has been changed.

Q Well, did you mean by "at that time" any particular date, 1962, '65, '68, '69, '70, what time are you talking about?

A I would say prior to the time that we moved the capital requirement ratio up to 1500 per cent.

Q I want a date. Can you give me a year?

A That we used the 1500 per cent?

Q Yes, sir. When that was of concern to you.

A It would be 1969, '68,

Q We have had testimony that at one time the level of concern was 1750 per cent. Do you recall such a time?

MR. BEEBE: Objection. I believe the testimony was not exactly like that.

MR. BROOKS: I believe Mr. McElroy testified that at one time it was 1750.

THE COURT: Either he affirms it or he doesn't. Go ahead.

Q Do you recall a time when it was 1750, sir?

A I think we also used that, too. It was a process of degrees as to the ratios getting closer and closer to 2000 per cent.

Q So these two levels of concern would have been operative at the same time; is that your recollection?

A Yes.

Q And that you would have a little more concern as it moved up to 1750?

A Correct.

Q You mentioned that the board of governors would post the name of a potential capital contributor in the normal process before they would vote on that person as a suitable or unsuitable capital contributor.

What did you mean by "post"?

A Posting would mean printing in the exchange weekly bulletin.

Q Who gets that weekly bulletin?

A I believe it's sent to all member organizations and many other agencies, and I would suspect anybody

that would subscribe to it.

Q Do you know the purpose of putting the name of the capital contributor in that bulletin, so-called posting?

A I believe it was to alert the industry, so to speak, of the person coming in and if anybody wanted to bring any suggestions or criticism of the name why they would bring it up to the secretary of the exchange.

Q If I understand you, this would be an opportunity for people to make known to the secretary any derogatory information about the person; is that correct?

A Correct.

Q And assuming thatthere was no such information made known or it didn't negatively impress the board of governors, they then would probably approve the persons whose name came up for a vote; is that correct?

A They would act on the application and the information that we had.

Q Exhibit 74, which I think -- did that go in, Mr. Beebe?

MR. BEEBE: Which is that?

MR. BROOKS: That's the one I suggested

before. Was it '74?

THE CLERK: It was in evidence.

Q Let's call it 74 now, although I think it's another exhibit as well.

Exhibit 74 is a letter by you to McDonnell & Company dated February 7, 1969. I believe you testified that this reflected an analysis done by the examiners of the answers to regular financial questionnaire. Those are the answers that aer submitted by the auditors, are they not?

A That is correct.

Q Is this the official position of the exchange on the interpretation, the results of that audit, at least as far as the net capital ratio that is reflected here?

MR. BEEBE: Objected to the words "official position."

THE COURT: Yes, sustained.

Q When you write a letter such as Exhibit 74 to a member firm setting forth the capital ratio that has been found by the stock exchange, what authority do you have to do that?

A This basically would bethe preliminary alert to the firm to our analysis. It would not be

the final outcome necessarily.

Q I see. So that this capital ratio that you are reporting that has been found by the analysis may be changed up or may be changed down as a result of further discussion?

A Absolutely.

Q You recite at the end of the first paragraph that our analysis shows that you were $510,780 below the requirement.

Then you go on to say on the next page that the firm has been told that they will have to get in that $500,000 by January 31 and that they will have to get in some more thereafter to solidify their position. That's a characterization.

Do you know whether they gotthat $500,000 they were told to get by January 31st?

A I have no recollection,no.

Q The paragraph above that tells the firm that hereafter in the future they will have to submit weekly capital computations to the stock exchange.

Do you see that, Mr. Spies?

A Yes.

Q Was that requirement a fairly standard requirement when a firm indicated a capital problem?

A Yes, it was.

Q Do you know whether McDonnell & Co. complied with that requirement that you set forth in your letter?

A I have no recollection without checking the files.

Q To whom would they have sent those weekly capital computations?

A To the finance division or to the compliance--to the coordinator, depending on who initiated the letter.

Q Exhibit 75, Mr. Spies, which Mr. Beebe showed you, appears to be a letter written by you to McDonnell & Co. announcing that at the March 6th meeting of the board of governors the board found Margaret Mary McDonnell Murphy an acceptable person to be a subordinated lender to McDonnell & Co.

Would that mean that the period for posting had expired and that she was found to be of good character to merit approval?

A Yes, it would.

MR. BEEBE: Object to "merit."

MR. BROOKS: Found to merit approval.

MR. BEEBE: I object to that question.

THE COURT: The sentence means to achieve approval from the exchange. It's a verb rather than a noun as I understand it.

MR. BROOKS: That's the way I meant it.

MR. BEEBE: With that understanding I withdraw my objection.

MR. BROOKS: No further questions.

THE COURT: Any redirect?

MR. BEEBE: Very few questions, sir.

REDIRECT EXAMINATION

BY MR. BEEBE:

Q You were asked whether weekly reports were required when a firm had capital problems.

Do you know if McDonnell & Company continued to have capital problems after January 1969?

A I don't recall.

Q You were asked whether McDonnell & Company -- your letter said, I believe, that McDonnell & Company was required to bring in $510,780 by the end of January and several million dollars I believe within a month thereafter.

My question is after those funds came in do you know if McDonnell & Company continued to be below the minimums required?

A I don't recall without reviewing the files.

Q You said that the 1500 per cent level of initial concern was changed later in the years that followed. What was it changed to?

MR. BROOKS: I object to the practice in the years that followed between 1969 and 1975. I don't think it's relevant to the issues.

THE COURT: After the events here? Are you asking him about a period after the events here?

MR. BEEBE: I believe it was and I won't press that if that is a matter of concern.

No further questions of Mr. Spies on redirect.

THE COURT: It's almost our recess time.

MR. BEEBE: Nothing further of this witness. I have a short redirect of Anna McDonnell.

THE COURT: We will take that in the morning.

We will stand in recess until 10 o'clock tomorrow morning, ladies and gentlemen. Thank you very much.

(Witness excused)

(Adjourned to May 8, 1975, at 10 a.m.)

[This page unnumbered and left blank]

MARGARET MARY McDONNELL MURPHY, et al.
v.
McDONNELL & CO., INC., et al.

May 8, 1975,
10 A.M.

(In open court, jury present.)

MR. BEEBE: Mr. Carr can't be here this morning, so we are calling Professor David Ratner as our next witness.

D A V I D L. R A T N E R, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BEEBE:

Q Sir, you are being called here as an expert. Could you explain your qualifications and start with your education, please.

THE COURT: Let me first explore, and perhaps we ought to do this in the robing room, as to what the area of proposed testimony is here.

Ladies and gentlemen, sit in place for a moment.

(In the robing room.)

THE COURT: Now, what is this man going to testify to?

MR. BEEBE: Professor Ratner is the man who was

the chief counsel of the last of a series of congressional studies about the securities industry in the period from 1967 to 1970, known, as we all know, as the paper crunch.

Congress conducted a series of extensive investigations, and his was the last one. His report, known as the Ratner report, was by the senate subcommittee on this similar subject.

Included in those studies were the very topics and the very areas that are factual and on trial today.

There are questions raised, as you know, your Honor, so far in the trial about what the exchange role is, what the responsibilities are in terms of the exchange in the structure of the industry.

We know, and those assembled here, I believe, are quite familiar how that particular industry works. It is like a doctor confronted with a broken bone, if you will. He has perhaps various alternatives. If there is a malpractice suit later, an expert is called in to explain to the jury what the state of the art is in that area and what the doctor was doing or not doing with regard to that particular injury or damage.

What we have done so far in this trial is to show what the state of the facts were from the examiners and the coordinators. Now the question to be resolved,

BEST COPY AVAILABLE

and which this man is going to make a contribution to, but not a definitive contribution by any means because the facts are for the jury to decide, is to show two things:

One, his opinion as an expert concerning the stock exchange -- the adequacy of the stock exchange's enforcement of the net capital rule based on extensive studies and factual investigations and his expertise in the area. I am talking talking about the particular time involved here.

The second thing he is going to discuss are the facts as they emerged from the investigations as they apply in this particular case. It is not an extensive bit of testimony but it is quite important.

THE COURT: Let me take this in two bites. What is his expertise beyond the fact that he was chief counsel to a congressional committee?

MR. BEEBE: The professor worked in the securities private practice in a New York Wall Street firm.

THE COURT: He is a lawyer?

MR. BEEBE: He worked in the securities field as a lawyer. He was a Harvard undergraduate student, Harvard Law Review, graduating magna cum laude. He is a professor at Cornell and teaches extensively in the securities area. He is little older than he looks. He is a member of the

committee on federal regulation of securities of the American Bar Association and an American Bar Association subcommittee on stock exchanges. He has written a case book on securities regulation and articles on securities regulation and the regulation of brokers and dealers.

He has also testified previously before the SEC where he was called as an expert on securities regulation questions, and he was also called by Senator Metcalf, invited to testify before a group of two senate subcommittees who asked him to testify last March on related areas of disclosure of ownership questions. He has never testified as an expert at a trial before. As you may know, it is very hard to find experts who are willing to testify concerning the New York Stock Exchange even in a neutral way. Believe me, I tried. I believe he is highly qualified.

THE COURT: Second question, in a nutshell what kind of things is he going to say? Is he going to say that the exchange utterly dropped the ball, that they should have done this and that? Tell me what you expect to come forth from him on the stand.

MR. BEEBE: Well, as I said, there are two parts to his testimony. One is really factual groundwork bringing into this courtroom facts which have already been the subject of -- which were adduced, elicited through

congressional investigations particularly about the net capital rule. There were extensive investigations on the facts of what occurred during the very years that we are talking about and why the exchange did what it did, which has absolutely nothing to do with proper regulation, it turns out.

The second aspect is the question of what the exchange should do in a general sense when confronted with a net capital problem. This man is not, of course, testifying about the particular facts of this trial because an expert doesn't do that. An expert testified as to the general picture.

In my mind I have been thinking of him as making a platonic picture of a platonic table, saying to the jury, here is a table and this is how the table should look, and then he is dismissed. He leaves the stand. And then the jury takes the facts as they have been adduced at this trial, compares them to what should have happened and reaches whatever factual conclusion they reach based on the facts in this trial.

This is a peculari industry, sir. We are somewhat acquainted with it and I think we know that the jury was selected in part because they are not familiar with the ins and outs of this, like the coal mining industry or some

BEST COPY AVAILABLE

other industry. It is somewhat to describe what the field is, what the area is.

THE COURT: Let me be sure I understand you, and I will hear from Mr. Brooks certainly.

Item number 1 is information culled from his congressional experience as to why the exchange was doing what it was doing. Is that essentially it? This would involve, obviously, basing a segment of exchange conduct on something that is nowhere in the record.

MR. BEEBE: I intend to put it in the record.

THE COURT: He can't put it in the record competently because he is testifying to what others have said and they may or may not be disputed. Maybe I have defined it less happily than you have defined it. I wrote down in my notes "Why exchange did what it did" as a synethesis of what you were telling me.

MR. BEEBE: I think the why is almost not in there, it is what the exchange did basically during this era.

THE COURT: See, the troublesome thing to me is that a jury credits an expert, and I have only been on the bench a year and a half but I used to try cases for years before that, and the expert gets on and he has or has not, as the case may be, an impressive list of credentials and the jury tends to say, well, this fellow, he knows what it is

all about. The question, as I see it, gets down to whether or not the area in which he is going to say what it is all about is really something on which they need that help or don't need that help.

Now, we have here proof as to what the exchange did, we have here proof as to what McDonnell was doing, what all the people were doing. As far as enormously diligent preparation can guarantee, we have the state of mind of every conceivable relevant participant to this thing, all the documents. Then the question is what the exchange is, as I see it at this point subject to change on argument, that is what the exchange did reasonably and within the bounds of their discretion and done in good faith. Those are the rough outlines of the circumscription upon them.

It seems to me that for a man who says I was a congressional counsel and say what the exchange did here, I don't know if we need him for that. We have had that.

MR. BEEBE: I am not sure they are not limited to the ones that you have highlighted.

THE COURT: You have a second issue; that is, what were the alternatives open to the exchange.

MR. BEEBE: Right. That's what their defense is.

MR. BROOKS: We have made no defense so far in that connection.

THE COURT: It may arguably be so, and I don't know whether you need expert testimony on this, maybe you do, for the jury to be made aware of the various options that exist under this statute. Then that requires the man to have a foundation that he is aware of the operations under Rule 6, Section 6.

MR. BROOKS: Isn't that really a question of law, your Honor?

THE COURT: Have you finished, Mr. Beebe?

MR. BEEBE: On your first point, I think that the main point is the facts are still emerging in this case. They are not completely out on the record by any means. We have laid, as I say, the groundwork but we haven't seen what the higher ups did, and that is the case that we have to meet.

It turns out that Congress did a study, and if you just take good faith, which you mentioned, sir, although I don't think that is a fair way to view it. I think the correct way is whether they regulated properly, which is quite a different thing than what's in their mind.

THE COURT: Regulating properly involves these subordinate criteria.

MR. BEEBE: Yes. I think the Dempsey Tegler case, for instance, overworked the words "good faith," the case out

in California, and that Judge Lasker's application, in the recent decision, it seems to be much sounder, in the Sloan case.

The point is with the congressional studies, they went into these very facts and they found indeed that the New York Stock Exchange completely failed to regulate, completely failed to do so because of the facts that are adduced in here. These are facts. These are not something that are argumentative at all.

THE COURT: What facts? What facts do you say? You are holding up three green volumes. What facts? How can I let a witness base an opinion on facts that aren't in the record?

MR. BEEBE: I intend to put these in.

THE COURT: I don't know that the studies are going to go in.

MR. BROOKS: I would object.

MR. BEEBE: I intend to offer them on a rule that permits the introduction of studies. In any case the witness will testify as to what Congress found, what the various Senate committees found the exchange did and didn't do during the period about regulating the net capital rule. It failed to regulate it. It purposely ducked it, purposely refused to do so, specifically as to three companies and one of those three companies is McDonnell.

THE COURT: Mr. Beebe, it seems to me that you could use that kind of informationto examine a witness from the exchange and say did you feel you ought to have done that, but to put in a Congressional study that says, we, the committee X, find this should have been done in this and that circumstance --

MR. BEEBE: Sir, I am not saying about the

should have been done aspect. Just this fact is true and this fact is true. I know I can go the second route and I may have to do that.

My point is since it's already been done once, for me to reprove it here is in effect to re-try what was done --

THE COURT: If you have a Congressional report which says the exchange didn't do something or other, then why are we having a trial, if I can throw out that footnote, because on your theory the issue has already been decided against the exchange.

MR. BEEBE: Yes, your Honor.

THE COURT: You have summoned six jurors here to decide whether in this set of facts between the exchange and McDonnell they did the right thing.

MR. BEEBE: I summoned six jurors here to find a verdict of liability because before I was unable to accomplish that through any other means.

THE COURT: I know, but their determination has to be on the facts before them, not rubber stamping or accepting a Congressional determination that you say in effect preempts -- has already reached a resolution.

MR. BEEBE: I can't ignore it. It's here.

Congress did it.

THE COURT: Incidentally, please, if you have any more surprises like this for me on Thursday morning, let me know at least on a Wednesday afternoon. I have two great law clerks who are a lot of help to me in beating the bushes.

I come happily to court on Thursday morning and I assume we are going to have routine-type testimony. I am prepared for surprises but these are major things. You can make even an ex parte submission to me if you don't want to tip your hand, but I could have used a little preparation in thinking about this before this time.

MR. BEEBE: I didn't realize it was so much of a difficult problem.

THE COURT: On the theory that Congressional records are going in, I ought to have a chance to see on what basis and then I would be much more knowledgeable either for you or against you, one or the other.

Mr. Brooks, what do you have to say on this?

MR. BROOKS: I think Mr. Beebe has mistaken the function of Congress for that of the federal court. We are here at Mr. Beebe's request before a jury to have the jury find the facts. I don't think we can

BEST COPY AVAILABLE

substitute the facts that might or might not have been found by some young fellows down there on a Congressional staff doing some kind of research and coming up with some kind of a report.

I think if we get into it on voir dire, your Honor will find out that the report that was concocted for the senate committee was based on hearsay, was based on selected documents taken from files of another agency, some of which are public and some of which are non-public.

I question very strongly its competency, its hearsay quality, and beside as Mr. Beebe has said, this man is here to testify about the world in general, to supply a platonic table.

But we are here to see what happened in respect to McDonnell. It could be the exchange acted differently in respect to McDonnell than it did generally.

This is a railroad accident at a particular crossing. It's not an inquiry into the railroads line from Chicago to New York.

I haven't heard very much about McDonnell, and I'll tell your Honor I have some familiarity with this report, and there might be one or two passing references to McDonnell in this report that this man's

BEST COPY AVAILABLE

expertise is based on and those passing references are quotations from other people's work. They are even in quotations in this report.

THE COURT: We are going to be another five or ten minutes, I assume?

MR. BROOKS: Yes, your Honor.

(Pause)

MR. BROOKS: I think it's safe to conclude, and a voir dire I'm sure will show it if Mr. Beebe doesn't show it now, that this man has no expertise in regard to McDonnell and has no expertise about the way the exchange enforces its capital rule. If we can't make the jury understand by people like Mr. McElroy or James McDonnell how the stock exchange works and how you treat these problems, I don't think he has the special expertise that is required to testify about it.

To the extent that he does, and he can testify about something which might tangently give the jury a little assist or background, I think the prejudicial impact of permitting someone like this to testify against the New York Stock Exchange, which is not the most loved creature in the world by him, it could be devastating. It could far outweigh any probative competent advance that this man could make to this trial.

I strongly object.

THE COURT: Mr. Loflin, do you have a desire to put a position on this record?

MR. LOFLIN: Yes, I would like to at least ask a question of Mr. Beebe.

Is this man's testimony going to be addressed against my client as well as Mr. Brooks' client?

MR. BEEBE: Well, you talk about railroad crossings. I guess he is an expert on railroad crossings in general, like an expert would be, but not on a particular railroad crossing involved.

That is what the McElroys and later Mr. Arnie will be talking about. That's the whole purpose of experts. He is going to be talking about stock exchanges, just what an expert should do.

I guess in that respect he will also be talking to the extent you are a registered national securities exchange, so in that respect you are swept in just as much as anybody else.

MR. LOFLIN: Thank you for clarifying that.

Your Honor, it appears to me that we have to keep in mind the purposes of a congressional legislative hearing and reports rendered in conjunction with such hearings and reports to Congress generally. They

solicit staff and have hearings for one purpose, and that is to enable the members of Congress to determine whether or not remedial legislation is needed or whether the present legislation is working properly, which is another way of saying the same thing.

A court proceeding, as I think we all know, exists for quite different purposes. The standards of evidence are different, the end result is different, and I think that approach goes to the evidentiary question that is going to be very real here in the event Mr. Beebe offers any of these congressional reports. I won't expand further on what Mr. Brooks said because he covered that quite well.

Beyond that, as your Honor noted at the outset, there is a question here of the need for the participation of an expert in any event. We have had two of the plaintiffs testify. Plaintiffs may or may not call T. Murray McDonnell. That's a decision that's up to them. They may or may not call other persons who were in positions of responsibility with McDonnell & Company. That's a decision for them to make.

But I say that the facts as to what McDonnell was doing, his relations with the exchanges, his condition at any particular point that may be relevant here can

be developed and to a large degree already have been developed.

By the same token, they have examined many New York Stock Exchange personnel. They must have some feeling for who knows what and who was in executive responsibility positions at any given time that has any relevance here. They can develop that side to the extent they haven't already through those witnesses.

It seems to me this is what the jury is here to do. You will instruct them as to the applicable law and they can hear from representatives of McDonnell & Co. on one hand or representatives of either of the stock exchanges on the other what the facts were. After they have been instructed as to the law, it seems to me that completes the picture.

Congress may not have concluded in '68 or '69 or '70 that the Securities and Exchange Law should be tightened in some way or that the Securities and Exchange Commission needed more funds to do its job or some congressman or senator somewhere along the line may have been critical of the activities of either or both exchanges.

I really think that kind of testimony, evidence, record not only is widely afield from what we

are doing, but is possibly poisonous. It may have a special effect on what the jury concludes about what we are doing.

MR. BEEBE: Perhaps as an officer of the court I can hand you something simply which may be good or bad for me. I don't know.

This is the new rule which I believe embodies -- and I have the annotations to the new rules which show the present situation. I believe you are somewhat of an expert on some areas of the new rules.

THE COURT: I wouldn't give testimony to that effect.

MR. BEEBE: Rule 803, subsection (8) reads:

"Public records and reports -- records, reports, statements, or data compilations, in any form, of public offices or agencies, setting forth (A) the activities of the office or agency, or (B) matters observed pursuant to duty imposed by law as to which matters there was a duty to report, excluding, however, in criminal case matters observed by police officers and other law enforcement personnel, or (C) in civil actions and proceedings and against the government in criminal cases, factual findings resulting from an investigation made pursuant to authority granted by law, unless the sources of information or other circumstances indicate lack of trustworthiness."

These are no little staff studies by young Turks in some little department. These were senate subcommittees.

There are criteria presently in effect according to the annotations here, factors which may be of assistance in passing upon the admissibility of evaluation reports.

MR. BROOKS: Your Honor, I think I can establish the untrustworthiness exception right away.

Just a quick reading of this report Mr. Beebe is talking about will show that it's not any data or any facts, but what this staff has done is to review some letters the SEC furnished to them, many of which are not public, and the stock exchange has not had an opportunity to see, and the study simply quotes from one letter at one time and another letter at another time.

It's not a finding of any facts. It's just a review of some correspondence.

If I might borrow from Mr. Beebe the book that contains the study, the study itself is prefaced by a disclaimer which I think makes any fact in it untrustworthy.

MR. BEEBE: There were four volumes, and a report.

MR. BROOKS: I will read from the case study of the interpretation enforcement of the net capital rule of the stock exchange, which Mr. Ratner I believe was chief counsel for.

"This case study of the interpretation and enforcement of the net capital rule of the New York Stock Exchange has been prepared by the staff of the subcommittee of securities of the senate committee on banking, housing and urban affairs. The staff has

relied primarily on published materials and upon the files of the Securities and Exchange Commission (the commission).

"The commission has cooperated in every respect in making its files available to the staff. Some of the documents reviewed by the staff were contained in non-public files of the commission. The NYSE has not had an opportunity to review such non-public materials and in some instances contests the validity or accuracy of the statements contained therein. It should be understood that the focus of the study is procedural rather than substantive.

"The relationship between the NYSE and the commission is examined in the context of the investigatory framework established by the Securities and Exchange Act of 1914. No attempt is made to determine the proper components of a good net capital rule. Because of the large number of events and volume of correspondence relating to the NYSE net capital rule during the financial crisis of the late 1960s no attempt at comprehensive treatment has been made. Rather, those events which may directly or indirectly bear upon the self regulatory process have been selected."

I think that it makes this untrustworthy as a report of facts. I think it's simply somebody

eavesdropping on others' correspondence.

MR. BEEBE: That is a building block document you have, sir. Here's the final report with the transmittal letter from Senator Williams to Senator Sparkman.

THE COURT: Yes, but this note, this preface, I take it was written after the report was prepared so that the --

MR. BEEBE: That's the hearings, your Honor.

THE COURT: But it's written afterwards, and encompasses the totality of what was considered.

MR. BEEBE: In that particular case, yes, which I don't find untrustworthy at all. Of course, it's selective.

MR. BROOKS: This is the study of which Mr. Ratner was the staff chief counsel. I think his name appears at the beginning of that book.

MR. BEEBE: It appears at the beginning of this book, too, as chief counsel. This is dated February 1973. But untrustworthiness I think is a question for the jury. If there is a prima facie showing of untrustworthiness, that's different, but that doesn't show it. It just shows they made a study

as authorized by Congress. By Senate resolution, I believe it is, to report its findings.

I would like to read one part of the final report:

"Dating back as far as 1964, the NYSE at times interpreted its net capital rule in such a way as to permit member organizations to remain in business despite what would otherwise be considered violations of the rules. The exchange takes the position that it did not follow this practice. However, the evidence is compelling."

That is the final opinion.

MR. BROOKS: That is for the jury to decide.

MR. BEEBE: This is a piece of education for them. I am not taking the whole case away from them.

THE COURT: Let's assume they didn't enforce it as to seven other companies. We are not trying other companies, we are trying one company.

MR. BEEBE: The problem is that this was their pattern during the whole period. I have to prove it as to this company. I am proving what the pattern was of the exchange at that time, and it was a concerted plan on the exchange's part, on which this

is an evidentiary piece of evidence that goes to prove it.

THE COURT: Let's go on now to item No. 2, and that is what were the alternatives open to the stock exchange. That is the second of the two fact areas, right?

MR. BEEBE: Yes.

THE COURT: Mr. Brooks, what about that? Isn't it legitimate for somebody -- assuming, we haven't crossed that bridge yet, but assuming there is a foundation that this professor, or congressional counsel, meets the test of competence, isn't this an area in which to determine whether the stock exchange acted reasonably and in good faith, that they could be advised of what the options are that were open to the exchange given the set of facts proven here.

MR. BROOKS: I am not sure what Mr. Beebe means by the alternatives.

THE COURT: This is my word. I don't know he used that word.

MR. BROOKS: Letme tell you what I think about it as it's been stated.

If he is talking about what are the alternatives permitted by law under section 6 --

THE COURT: That is what I am talking about.

MR. BROOKS: That is for your Honor to instruct on the basis of the case law. If he is talking about what are the alternatives economically or as a matter of pracitce, I don't think this man has that expertise to tell us that. I think there is nothing in his background which shows that he has ever been the kind of regulator that has ever had to answer these questions.

THE COURT: Let's pass that. I wanted to assume for the moment that he has that skill.

MR. BROOKS: If the alternatives are --

THE COURT: Suppose, to put this in a little different focus -- suppose Mr. Bishop were for any reason to have departed the exchange last year, and Mr. Beebe were to have engaged him for appropriate remuneration nnd he were here to testify as to the alternatives that the exchange had before it in 1968 and in 1969 and in 1970, would that not be appropriate for the jury to consider? He could say "We could have done this and that."

MR. BROOKS: I think it's appropriate for the jury to consider, when considering the issues of reasonableness and good faith, what the choices were.

THE COURT: That's what I am saying.

MR. BROOKS: We go this way, that way, or maybe a third way.

THE COURT: And not necessarily that we are restricted to one choice. Because as I read the authorities, the memo that was worked up for me, there is a substantial area or discretion within which the exchange can act in a number of different ways, all of which would be reasonable within the law.

MR. BROOKS: I agree.

THE COURT: As I understand the law to be.

MR. BROOKS: I think it is relevant.

THE COURT: This is my law clerk's workup for me on the authorities, and they have been doing their own digging and worked up a memo of law on cases that they felt would be of assistance to me.

MR. BROOKS: I think to know the alternatives is certainly important and proper.

THE COURT: My clerk's memo was there is an area in which one could say the number of alternatives -- all of which were reasonable, certainly, viewed from foresight.

MR. BEEBE: I would just add I hope before they reach some final determination in any case they would have access to these studies, because it's just the

contrary conclusion Congress found.

THE COURT: Mr. Beebe, I would be delighted to do that. Frankly, in that connection I was going to suggest to all counsel that -- not that I want to add to anybody's weekend chores, but we obviously are going to have a strenuously urged motion to dismiss at the close of hte plaintiffs' case, and I wanted all counsel to really be armed to the teeth with both the facts and the law on this, because it's a motion that will take, to reach the right result it will take a substantial factual analysis, it seems to me, at this point, of what is the total picture, how does fact X affect it one way or another.

I can see that there are certain things that have gone in from which you will argue to me that this or that fact requires submission to the jury.

For example, the press release that goes out without the stock exchange making a check to determine whether there is in fact -- at least on the state of the present record -- whether there is in fact three to ten million dollars coming in, does the jury have a right to find that that is irresponsible conduct in some way? Is there some duty to act when thatcomes in? Are they supervising the press releases? Maybe they are or

aren't. Maybe the situation requires they do or don't.

Also, maybe an argument can be made that even if they were, the issuance of that press release didn't have anything to do with the injuries to your client.

The motion to dismiss here is going to be a very complicated kind of thing which I find troublesome because it conceivably could be a proper one that should be granted, even on a complicated set of facts. If there is no conceivable alternatives that required it to go to the jury, it shouldn't. If it should have to be, it will be.

I am asking counsel to be armed to the teeth and argue it extensively.

MR. BEEBE: Maybe counsel can exchange trial briefs to see what one side's views are. This comes as somewhat of a surprise to me that alternatives available is an issue or needs to be extensively briefed because I haven't seen a good deal of evidence come in, on our case anyhow,as to alternatives available to the exchange.

If they have been introducing evidence on cross which they are going to argue supports that proposition, in effect they have already started to make their case and those are issues of fact and there

really isn't left to decide on the law without your mind having facts which you have to resolve, if you follow.

THE COURT: You are premising your statement on a comment of mine. I have read your proposal as to the expert's testimony as being one that he would be testifying as to the alternatives open. I was observing in that connection that on the independent research that my law clerks have done that I saw a lot of discretion, which necessarily means that alternatives can be availed of and that there isn't necessarily an absolutely right answer under Section 6 regulation. That is all I am saying to you. I am saying nothing more than that.

Perhaps in time I will be glad to give you the benefit of the research I have had done, and I trust that I will have the benefit of whatever research you have had done, and we will do the best we can.

MR. BEEBE: Can we have an exchange of trial briefs? Is that an appropriate thing in preparation for this legal and factual argument that may be upcoming?

MR. BROOKS: I would object to that. We played this very close to the investigation, so far, witness Mr. Beebe's surprise this morning.

I would like to try to maintain our position in that respect.

THE COURT: In other words, you are saying the memorandum has factual presentation that is not yet forthcoming.

MR. BROOKS: It certainly has. We haven't put in any of our case on the facts, or very little.

THE COURT: In my discretion then I will continue to maintain the posture in that regard.

On the other hand, if you want to exchange the authorities here that each of you is relying on, I don't see any harm in that.

MR. BROOKS: I can't imagine they are not aware of the same authorities we are.

THE COURT: I can't, either, because it seems there is half a dozen of them. My law clerk told me thatI was at sea in a very small boat with no buoys in effect.

MR. BEEBE: I don't know whether Judge Lasker in his decision last week represents --

THE COURT: He is a flashing buoy on the horizon.

MR. LOFLIN: I have one citation in my brief though I don't know whether they are aware of or

not. It's Carr against New York and American Stock Exchanges. I have represented in a trial brief I found that that presented issues analogous to those in this case.

THE COURT: Was that before Judge Metzner?

MR. LOFLIN: No, Judge Spencer Williams in San Francisco in March of this year. My problem is proceeding much further with its description is he has not written an opinion, he has granted a minute order granting summary judgment for the stock exchange based on our contention that the rules of the American Stock Exchange do not require it to maintain financial oversight of dual member firms -- that is, by that I mean firms that also belong to the New York Stock Exchange.

MR. BEEBE: Is there a way we can find the factual situation there?

MR. LOFLIN: Mr. Greathead is familiar with it and will work it out with you. I can't tell you anything about the judge's opinion because as of this moment he hasn't filed one. He granted summary judgment fromt he bench on March 14, 1975.

mdh 1

MR. BEEBE: I think as far as the Amex is concerned we are relying on the factual basis here, and there are no peculiarities of law that pertain.

THE COURT: Let's get back to my other thought then. What is your position on letting this gentleman testify, assuming he meets the qualifications, which he may or may not meet?

MR. BROOKS: What alternatives are we talking about?

THE COURT: I don't know he is qualified as an expert in stock exchange alternatives under Rule 6.

MR. BROOKS: Are we talking about an alternative of whether when you have a net capital violation they should be shut down immediately or be given a reasonable chance to contribute more capital and get themselves in compliance?

THE COURT: Why don't we ask Mr. Beebe, because we might have to have an offer on this in any event.

MR. BEEBE: I am going to ask him that very question.

THE COURT: You have some idea of what he is going to say, I assume.

MR. BEEBE: I think he is going to say to the effect that Congress mandates a net capital ratio of 2,000 per cent. It is in the Act. It's got the number 2,000 in

the statute.

We marked as an exhibit Section 6 of the exchange which says it will enforce, as well as the SEC, the provisions of the Act. The exchange did that. It said it would enforce it.

Now comes the question: You have a net capital violation. Let's say we prove that, and that is an assumption we have to make in the hypothetical to the expert. What options does the exchange have under its own rules and under the congressional mandate? It is a question of--

THE COURT: What does he say?

MR. BEEBE: He says they have to enforce it.

THE COURT: What does that mean, enforce it? Does that mean if you are 2,010 you are out of business?

MR. BEEBE: No, it is not an instantaneous thing. It is a question that you can't answer because you believe it is better for someone else that you not enforce it, if you have what one of the witnesses called competing considerations-- I will have to look back in the transcript.

MR. BROOKS: I think it is competing values.

MR. BEEBE: Something along those lines.-- that you can elevate these competing values to something higher than what the exchange has mandated and you have agreed under Section 6 to undertake to do. You can't

substitute that because you have a conflict of interest, which the exchanges do, and there is no dispute about that. They are both regulatory bodies and trade associations. They like to make money, and at the same time they have agreed to regulate themselves because they think it is safer to regulate themselves than to have someone else do it.

There comes a point of conflict. If you have a big enough company with enough weight, if you will, in the exchange, it can push back when the regulatory crunch comes and squirm out from under. If it is 2,001 per cent or something like that, that is for the jury perhaps to feel if it is de minimus. The vidence here is quite to the contrary. It was of vast proportions, with funds, assets, earning power, and value of the brokerage house being drained away, siphoned off for the benefit of everyone except the subordinated lenders, and perhaps others. I am not talking about them, but our clients were left with nothing, and they were left because it had been drained off. That's really the essentials of that whole stream of thought.

THE COURT: The argument the other way -- I am listening to all of this as best as humanly possible in accordance with my instruction to the jury to keep an open mind, but the argument the other way, as I see it -- and

this is why I am troubled by an expert testifying -- the argument the other way as I remember the facts McDonnell & Company did not reveal a violation of the net capital rule until a bi-montly report in the middle of January of 1969, if I am not mistaken.

MR. BEEBE: I think you are absolutely right.

THE COURT: The October audit was not in until a week or two later, toward the end of the month, so it wasn't until the very end of January that there was a record admission by the company it was in violation. Up to that point it had not been. People may have had a good idea about it, but you certainly can't fault the stock exchange for not moving on suspicion.

MR. BEEBE: If I can correct one small point. The audit came in on January 15th.

THE COURT: It then seems to me from the cases I have read that the exchange-- and I am saying this is their position, as I see it -- the exchange can't necessarily act until there was a big dispute about how substantial this violation was. Some figures said it was 5,000, and some figures said it was in the 2,000 range.

It seems to me the exchange would be criticized for acting precipitously until it did its own inquiry to make sure of its own facts.

MR. BEEBE: They are talking about Ira Haupt and saying don't do the same. I am not suggesting that.

THE COURT: You then come down to the position where they say that Murray McDonnell -- and they get a little bit pushy with him -- Bishop says you are going to have $500,000 by next week.

MR. BEEBE: The next day.

THE COURT: Whatever it was. I assume that occasion is the call to the plaintiff Margaret Mary.

MR. BEEBE: Both the mother and the daugher were called.

THE COURT: When the exchange reaches a tentative view it then enforces it saying you get it in or, and apparently the left of it is left dangling.

Given that situation, do you want to take the position that here the minute that they learned that they had a duty to put this company out?

MR. BEEBE: Two positions. The first position is that it is completely unethical, unfair, and a violation of all the disclosure requirements, which is not what we have been talking about so far this morning, to tell someone "Thou shalt go out and raise money" when you know the company is in violation, and you, the exchange, take no steps to make sure that when the money is raised the people

who are going to be the pigeons are told what's happening back at the exchange and back at McDonnell. That is to me an extremely -- it is an awful thing for them to have done, and I think we can prove what the legal consequences of that are.

THE COURT: What I was focusing on was your statement that McDonnell was a big company here, and was by reason of its size getting favored treatment from the exchange.

MR. BEEBE: That's right.

THE COURT: It seems to me that the argument to the contrary might be made on the basis of the fact that Bishop said "You are going to get up half a million dollars or else."

MR. BEEBE: As of that point I have not proved my case. This is January 29th, and I haven't done it on that issue.

THE COURT: At that point, as I remember, according to certain statistical stuff, they apparently became in capital compliance for some months.

MR. BEEBE: That is a subject or real dispute as to whether they ever came into compliance or not.

THE COURT: Since it is a subject of dispute, is the exchange then required to knock them out when it is

MD7

a subject of dispute?

MR. BEEBE: The question, sir, going after January 29th, is why didn't the exchange take forceful measures immediately?

Margaret didn't come in as a subordinated lender despite putting her money in -- they didn't get approval until March 7th.

THE COURT: Her money had gone in.

MR. BEEBE: Yes, but if the exchange had said, "We can't give you approval unless you notify the person and get either a knowledgeability letter or something from them saying that they knew what was going on" -- I mean it wasn't just that there was a violation, they were losing money, they had a man just withdraw $400,000, one of the partners apparently had withdrawn $400,000. No notification of that, Operations problems continuing horrendously. And that is a violation of another rule --

THE COURT: I appreciate all of that, and without expressing an opinion it would appear at this point Murray McDonnell was trying by any means possible to keep this company alive.

MR. BEEBE: And the exchange was not controlling him. That is my point.

THE COURT: The question is what was their duty at

MD8

that juncture?

Let me ask you this: Much is made of this knowledgeability letter. I have a feeling that the claim is going to be mad e that there was no legal duty to demand a knowledgeability letter, and what the knowledgeability letter really was was a lawyer's effort to protect the exchange against unwarranted suits so they can move for summary judgment instead of having to sit through a case, but there s no legal requirement.

I think that is the argument that will be made somewhere along the line, as I sense the way the letter is structured -- that it is an effort to prevent against what the exchange feels would be an unfair suit because of the fact they said, "Get the money in."

MR. BEEBE: I guess they can say that. It says on its face --

THE COURT: It is an insurance policy rather than a legal requirement.

The question is what I am going to have to instruct the jury on that point.

MR. BEEBE: I think it is a question of whether they gave similar notice. I am not talking about the disclaimer aspects of it. I am talking about the notice aspects. The idea is, will you go out and find out what is

going on in this company?

I think we will have testimony, if we haven't gotten it in already, the knowledgeability letters were issued in cases where there were problems with the firm, capital problems with the firm.

Why wasn't it issued here? For the reason that they desperately wanted to let McDonnell get the money.

THE COURT: You are saying that Margaret Mary should have had to sign a knowledgeability letter before the money was accepted?

MR. BEEBE: Something that said, "I am on notice I should make an investigation as to the capital and operating conditions of the company," or something along those lines.

There was nothing. No notice. And they had adequate, ample, and extensive reasons for doing it. That's why I go back to 1967, and the prior restrictions. They had tons of notice of these things.

THE COURT: You are helping me out very much in terms of getting a feel of where everybody is. We still have to grapple with this witness.

Myinclinetion is to see whether he is qualified to express an opinion on the alternatives that are open to the exchange in the years 1968, 1969, and 1970.

MD10

MR. BEEBE: Could I run by a series of neutral questions and see if I can get these things from him, with everyone's okay?

THE COURT: First, he has to pass the qualification test. While he has an impressive list of qualifications, that doesn't necessarily make him an expert in this area.

MR. BEEBE: I have a series of questions about what is the stock exchange, that sort of thing, which has never been pulled together for the jury.

I really wanted that from the neutral point of view, for him to explain as an aid to them where this all fits in. This seems to me the classic role of an expert, a bona fide neutral expert.

I would have taken an SEC commissioner, if I could have gotten one.

MR. BROOKS: That is not an expert question; it is a question of fact. We have a certificate of incorporation, we have rules, we have officers here. They can tell anything they want to know about the stock exchange. And all stock exchanges aren't the same anyway.

MR. BEEBE: I don't think tnat is fair, because the rules, and so on, they don't speak -

THE COURT: Let's go on. What is the next question?

MD 11

MR. BEEBE: What is the function of a stock exchange? I can give the answers I anticipate.

THE COURT: Let me hear the questions. I can appreciate what you are shooting at.

MR. BEEBE: The function of the stock exchange, how it relates to brokers, the brokers who are the members of the exchange, how it relates to the SEC, what is the register of the National Securities Exchange, who are the major partic ipants in the securities industry, what is the role of each of the participants, what is the role of each of the participants, what is the financial operation.

And that is very important, sir, because there you talk about the fact that brokerage houses are very heavily debt structured. They borrow their customers' money, and that is very important in terms of Rule 325.

Apparently, there is some argument that the fact a guy has a serious Rule 325 violation doesn't mean he has a financial problem. I think that is -- I am not going to -- I suppose I have to get some evidence in to counter that. But that to me is amazing, that that raises an issue.

The last one is: What is the function of the net capital rule?

Then I will turn to the hypotheticals, as I will be permitted to do so.

MR. BROOKS: I think those are all questions of fact, your Honor. They are not for an expert to give. They are not opinion. They are not expert opinion. They are questions of fact. And they are questions of fact even as Mr. Beebe has phrased them in general. They are not questions of fact as to the stock exchange, the capital rule, and McDonnell & Company. Any of those facts can be drawn out of the documents already in evidence, or the witnesses or documents that are publicly available.

MR. BEEBE: I think that is the role of an expert, to testify as to generalities, so that when you have an industry mentioned such as I mentioned the coal mining industry, or some industry that is not familiar to everyone, there is an expert who describes it.

THE COURT: Mr. Brooks, let's assume he did testify to that, so what?

MR. BROOKS: I think it will not be the best evidence on it and it will be in a biased and colored way. I think the best way to get it is from the documents and from the evidence that's properly put before the jury on the facts of our case and not by some professor who has been in Washington for a couple of years and wants to tell us what the securities industry is like.

We have the people here who know what the securities industry is like as to these problems that we are dealing with. Mr. Beebe is free to call any of them. In fact, he has me holding them on standby. He has all the documents.

MR. BEEBE: I haven't got the neutral people from the other side.

MR. BROOKS: I don't think this man is neutral.

THE COURT: Well, Iwant to give some thought for a few minutes here, so why don't we take a recess for 10 minutes.

Anybody want to say anything more?

MR. BROOKS: I take it before the man is permitted to testfiy we will be permitted a voir dire in that event.

THE COURT: Unquestionably.

(Recess)

(In the robing room.)

THE COURT: Yes.

MR. BEEBE: Sir, based on the discussion here earlier and the way things seemed to be going, I think that I would just like to use the expert to explain the structure -- the structure questions that I ran through at the end, which are very neutral. I would like to make a try, and I can do it here or out there, in terms of the congressional studies that he was in charge of and what their conclusions were and the facts elicited under Rule 802, sub part 8.

THE COURT: Mr. Beebe, I am going to rule against you on the studies. I am not going to permit those studies to go in.

MR. BEEBE: I see.

THE COURT: Now, on what the securities industry is like, if that is a capsulization, I don't want to get into it in any great length because this is instructive and not factual, but I will permit some modest professorial observations as to what he knows. That's it. That is all you are going to want from him; is that it?

MR. BEEBE: Based on the rulings here this morning.

THE COURT: I haven't ruled on anything else.

MR. BEEBE: I know, but based on the discussions this morning, that is what I am going to ask him.

THE COURT: I will permit him to ask you that and I will rule out the studies.

Now, do you want to mark those studies as an exhibit for identification?

MR. BEEBE: Certainly, your Honor.

THE COURT: In case you want some court to rule on whether or not I am in error in excluding them.

MR. BEEBE: I will have them marked. I'm not saying anything about other courts.

THE COURT: To protect your record you ought to mark those so that it has been done.

MR. DUBIN: We may have a time problem now that we have changed our tactic. It is 11:30 and I think the professor won't be on that long and depending on cross we won't have our next witness available, who will be Mr. Arning.

MR. BROOKS: At plaintiffs' request I have Mr. Arning standing by for a telephone call with the general expectation he would be here at 2 o'clock if he got called.

THE COURT: Can you get him earlier?

MR. BROOKS: I can try to reach him.

THE COURT: Do that.

MR. BROOKS: When would you like him here?

MR. BEEBE: As soon as we are done with the professor.

THE COURT: I don't think you are going to cross-examine him at any great length.

MR. BROOKS: I would want to do a good amount of voir dire to show bias against the Stock Exchange.

MR. BEEBE: I don't think I am asking any questions that call for an inquiry into that area. If I ask a question along those lines, then perhaps that would be an appropriate point to raise that.

MR. BROOKS: His bias is relevant to anything he says on that stand. He is being presented as a neutral expert, professor and government official. I think this man has a predetermined set that he would just as soon have the New York Stock Exchange vanish.

THE COURT: Well, this would be cross-examination, Mr. Brooks.

MR. BROOKS: Wouldn't it be voir dire?

THE COURT: Not if he meets the qualifications to give testimony. He would testify as to his qualifications and I would then as a matter of law rule that he was either competent or not competent.

MR. BROOKS: May I inquire in the qualification

area then, if necessary?

THE COURT: If necessary, surely.

MR. BROOKS: Can you state again or more clearly what area he is to be permitted to testify?

THE COURT: As I remember, Mr. Beebe said he had in mind having him say what the Exchange was, a little bit of its history, how it was structured, the method by which it operated, some of the financial arrangements within the brokerage firms themselves, things of that kind, which seem to me to be more historical than argumentative, if I can put it that way.

If that is so, there may be no cross-examination at all on your part.

MR. BROOKS: Right.

THE COURT: Which is why I have a feeling that you ought to save your bias questions until you are sure that it is required.

MR. BROOKS: The only questions that would be proper on voir dire is whether he is really an expert on these questions of the structure and history of the securities industry.

THE COURT: Right.

Now, Mr. Beebe, I want to have you tell this gentleman that in the course of reciting his qualifications

obviously he is going to testify that he was the chief counsel of a study of the securities industry in Congress from '67 to '70. I don't want a breath out of him on any conclusions that they have drawn, any feelings that they may have reached, anything of that kind. I am not saying this because I have any concern of your getting into it, but I have some concern that the witness himself may get into it in terms of exuberance in stating what he did.

MR. BEEBE: I have also searched, I should say, far and wide for someone who sat so far up in the clouds that he never took an opinion or took a side one way or another. I couldn't find him.

THE COURT: I just don't want on this statement of qualifications to have any results or opinions coming in. Please instruct him accordingly.

(In open court, jury present.)

D A V I D R A T N E R, resumed.

THE COURT: Go ahead, sir.

BY MR. BEEBE:

Q Where did you go to college, sir?

A Harvard College, class of 1952.

Q And where did you go to school after that?

A Harvard Law School, class of 1955. I was article editor of the Harvard Law Review.

Q And did you graduate with horns of some sort?

A Magna cum laude, they call it.

Q Did you enter into a professional career thereafter?

A Out of law school I started work in a law firm on Wall Street where I stayed for eight years doing mainly securities and corporate work, public offerings and similar matters.

Q And then did you return to the academic fields?

A I did. I received an invitation from Cornell University to go up there and teach law, and I have been teaching law there since the beginning of1964, subject to some leaves of absence during that period.

Q Are you now a full professor there?

A Yes. I have been a full professor since, I think, 1968. I teach securities regulation is the principal subject. I also taught corporations, accounting, antitrust law, constitutional law, equity, consumer protection, agency, a couple of others I may not remember.

Q Are you a member of any professional societies?

A I am a member of the American Bar Association, and particularly of its Committee on Federal Regulation of Securities and the Subcommittee on Stock Exchanges and the NASD.

Q Have you published any articles, sir?

A I have published several articles, one on regulation of the compensation of broker-dealers, one analyzing the role of the Securities and Exchange Commission, and others on corporate voting rights and other matters relating to corporations and securities.

Q Have you published any books, sir?

A I have a --

Q Written any books.

A I have a law school case book covering securities regulation generally, which was published in January of this year.

Q How old are you, professor?

A 43.

Q Did there come a time when you received a call from Washington and went down there?

A Well, actually twice. In the summer of 1966 I was asked to come down as executive assistant to the Chairman of the Securities and Exchange Commission, and I served in that capacity for two years, from the summer of 1966 until the summer of 1968.

Q And was there a second time when you went down?

A Then in the summer of 1971 when the Congress was commencing studies of the securities industry, I received invitations from people connected with both the House and Senate subcommittees that were conducting the investigations.

Q Did you serve as chief counsel when you went down there of the senate subcommittee?

A Yes. I went down there. I interviewed both of them. I accepted the position with the senate subcommittee and I spent a little over a year and a half there, from July of 1971 till January of '73 acting as chief counsel for the study being conducted by the securities subcommittee.

Q Who did you report to, sir?

A Senator Williams of New Jersey was the chairman of the subcommittee.

Q Are you receiving a fee for testifying here?

A Yes.

Q What is the fee that you are receiving?

A I am being paid $50 an hour for my time actually spent working on the matter, preparing, plus travel expenses.

Q Have you ever testified before as an expert, and I'll start with before the Securities and Exchange Commission?

A I testified before the SEC December of last year in connection with their proposed rule ending fixed commission rates on stock exchanges. That's the

only time I have testified before the SEC.

Q Have you ever testified before any Congressional subcommittees and at whose invitation?

A Yes. I think it was in March of last year I testified before two subcommittees of the committee on government operations of the Senate, which was looking into concentration of stock ownership in large corporations. I was invited by Senator Metcalf I think on the basis of an article and some work I did for them on that subject.

Q Have you ever testified at trial?

A No.

Q Sir, could you explain for the jury in general what a stock exchange is?

A Well, a stock exchange is really several different things, as they have developed here. The stock exchange --

MR. BROOKS: May I interject, your Honor? We haven't yet had a determination of whether the witness is or is not to be permitted to testify as an expert.

THE COURT: You are raising an objection that the qualifications are not sufficient for this purpose?

MR. BROOKS: On the area that I understand the

witness is to testify, on the basis that is now laid, I will not object.

THE COURT: Very good.

Q You were starting to say, sir.

A Yes. The exchanges are, in the first place, the actual physical facility. In most cases there is a building with a trading floor to which the members of the exchange have access to take orders from their customers and the exchange, at least as the law is written, an exchange could be an independent entity, simply charging fees to people who came to execute transactions.

In fact, all of the stock exchanges registered with the Securities and Exchange Commission are in fact membership associations or corporations in effect owned by the members who do business there. So that it is a facility owned by the broker-dealers who use it to transacttheir business for the account of their customers.

The exchanges generally have limited memberships or a limited number. The New York Stock Exchange, for example, is limited to 1366 members. And so a membership has value to a person who wants to conduct business. The seats on the New York Stock Exchange have sold as high as over $500,000 in 1968. In recent

times the value of the seat has been lowered. It is now, I think, below a hundred thousand.

The exchange then is sort of a facility which its members can use and is in effect owned by them and operated for their benefit.

Another aspect ofthe exchanges is that they regulate the conduct of their members. This is another aspect of their activity. In addition to actually operating the trading floor, they have departments which regulate the members' conduct in several respects. Their conduct actually in trading, the rules governing the bids, prices at which they can trade stocks, the relationships with their customers, fair trade practices.

Until recently the exchanges regulated the charges that brokers had to make to their customers. That's recently been eliminated by order of the Securities and Exchange Commission.

The exchanges have also generally undertaken to regulate the financial responsibilities of their members by various rules designed to assure that they are financially responsible.

MR. BROOKS: Your Honor, I think the witness should be instructed to direct his testimony about the nature of the exchange as it was at the time period with

which we are concerned within this lawsuit, '68 and '69.

THE COURT: Yes, that is appropriate.

Professor, otherwise we will bet into a confusing issue. We are talking about the years '68, '69 and '70.

THE WITNESS: I will, your Honor.

THE COURT: Thank you very much.

A In talking about regulation, perhaps I ought to place the exchanges in the context of the whole system for governance of the securities markets.

Going back to 1934 you have a congressional determination that trading in securities markets is a matter of national concern, subject to national regulations. So ultimately the authority to regulate what goes on in the securities markets and what securities dealers do belongs to Congress.

Congress obviously can't legislate every rule and change them every day in accordance with conditions, and Congress in 1934 established a new government agency, the Securities and Exchange Commission, which was to regulate the activities of broker-dealers generally.

MR. BROOKS: May I interject again? I'm sorry. This is most interesting but could we proceed somewhat more in the customary question and answer method

rather than a narrative exposition?

MR. BEEBE: I think thiy is appropriate for an expert. It's easier if he just testifies.

THE COURT: We are getting the history of the setup as it existed in '68, '69 and '70, I assume.

I will permit it. Go ahead.

A The Congress is sort of the source authority generally. The Securities and Exchange Commission operating by mandate of the Congress to regulate the industry.

Now, where do the exchanges fit in in this picture? The exchanges, of course, predated the passage of the 1934 Act and they had been regulating their members.

Congress was faced with choices whether to have the Securities and Exchange Commission supersede the role of the exchanges in regulating --

THE COURT: Professor, why don't you tell us what they did do, please.

A What they did is they said we will leave the exchanges in the position of regulating their members but we will require every exchange on which business is conducted to register with the SEC. In order to register it will have to file its ruling wiht the SEC and those rules must be satisfactory to the

SEC in terms of promoting just and equitable priciples of trade. It will also have to file an agreement with the SEC to enforce the provisions of the 1934 Act against its members as a condition of registration.

Pursuant to that the exchanges registered with the SEC, most of the major ones. The situation then was that the exchanges had the primary responsibility for regulating the activities of their members subject to theSEC's power to discipline an exchange, to revoke its registration if it didn't comply with the statutory mandate.

Q Thank you, sir.

We have marked this morning for identification the agreement by which the New York Stock Exchange agreed to become a national securities exchange, at least the one that was in effect in 1968.

I offer it as 77.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 77 is received in evidence)

Q Sir, could you explain the financial structure and operation of a typical brokerage house in this industry?

A Let me try --

MR. BROOKS: Your Honor, I don't know if we have a foundation for that kind of testimony from this witness yet.

MR. BEEBE: In relation to rule 325 and the SEC rule that mandates the 2000 per cent.

MR. BROOKS: Same objection.

MR. BEEBE: I can lay a further foundation with this witness if it's required concerning his studies in these areas.

THE COURT: Let's find out first is there a typical brokerage house in terms of its capital structure and how it's set up? Do we have such?

THE WITNESS: While there are a variety of securities firms that engage in different mixes of business, there are certain unique factors to the securities industry that have necessitated a particular kind of regulation which is exemplified by net capital rules, if I could just describe that briefly.

THE COURT: We have had the net capital rule explained at some length. The question is, Professor, what is your background in terms of familiarity with the capital structure of various brokerage houses in order to have some assurance here that your testimony will be

helpful to us in this area?

THE WITNESS: Let me amplify on the study conducted by the Senate subcommittee for which I was chief counsel in '71 to '73.

The genesis of that study --

THE COURT: Without getting to the genesis, what experience did you get in terms of looking into brokerage houses?

THE WITNESS: What we studied in the course of that study was the nature and problems of capital structures of brokerage firms, and the effectiveness of existing regulation in dealing with them.

THE COURT: I see.

THE WITNESS: And the need for change.

THE COURT: Just approximately how many brokerage firms did you personally study in depth in terms of material supplied to you?

MR. BEEBE: In terms of material supplied to him?

THE COURT: Yes.

THE WITNESS: In general, our study concentrated more on overall industry figures which we obtained from the Securities and Exchange Commission, the exchanges, and other sources, rather than investigations of the capital structure of individual firms. We studied the overall picture.

THE COURT: Mr. Brooks, do you want to inquire further here? I feel it's more appropriate for you to inquire.

MR. BROOKS: I might ask a few questions.

VOIR DIRE EXAMINATION

BY MR. BROOKS:

Q Professor, did you ever personally investigate the capital structure of any particular brokerage house, you yourself by looking at their books and records and visiting their shop?

A In terms of looking at financial statements of brokerage houses, I do look at sample ones. I did not conduct an investigation of any particular brokerage house, no.

Q Is that the full extent of it, looked at the financial statements of some brokerage houses?

MR. BEEBE: Full extent in terms of what people might have reported to him?

THE COURT: No, I will let you ask questions later.

MR. BEEBE: I am sorry.

A Excuse me.

Q You said yourexperience with any particular brokerage house consisted of your examining some financial statements for some brokerage houses. Is that it, as far as personal experience that you have had in looking at the financial structure of brokerage houses?

A No, because our basic examination was of the

information which others had collected.

Q You mean a compilation for the industry as a whole?

A And for particular groups of firms.

Q Let's just talk about the financial structure of any one brokerage firm. Is it your testimony that the only thing you looked at was s sampling of financial statements?

A Yes, because we were not studying individual brokerage firms.

MR. BROOKS: Your Honor, I think the witness might be competent to testify about the overall industry, since he has reviewed compilations, but not about the financial structure of any particular brokerage firm.

THE COURT: I agree with you on that, and I will permit him to go forward on that basis.

MR. BEEBE: I thought that is what I was trying to do when I said a typical firm, I didn't mean a named firm.

BY MR. BEEBE:

Q Based on that clarification, will you go ahead?

A The problem that gave rise to the congressional concern that gave rise to the study --

A No, no.

Q The precise question, sir, is: How is a brokerage firm in this industry structured financially? What is the financial setup?

MR. BROOKS: I don't think he is competent to answer that.

THE COURT: Yes. I don't see that coming within his competence, and I will sustain an objection to that.

Q When your studies were made what did you find about the industry as a whole relating to its financial setup?

A What we discovered was that the unusual factor in this industry was the extent to which cash and securities owned by customers were put at the risk of the business. This was the distinctive feature. We found that in 1968, for example, there was approximately 3.6 billion dollars of cash belonging to customers that was in the hands of brokerage firms that they were able to use and commingle with their own funds, of course subject to the obligation to-- it was a debt to the customers. But was the availability

of this cash and marketable securities belonging to customers in the hands of the firms that gave rise to the concern about assuring their financial responsibility so that the customers could have some assurance of getting their cash and securities back.

MR. BEEBE:: Thank you very much, Professor Ratner. I have no further questions.

MR. BROOKS: I have no questions of the professor.

THE COURT: Thank you very much.

(Witness excused.)

MR. BEEBE: I call Mr. Arning.

MR. BROOKS: We have Mr. Arning on standby by a telephone call. He had gone to lunch when we called, and we left word. I think the best we can expect is to have him here at 1:30 or 2 o'clock.

I understand the plaintiffs do want to read from Mrs. McDonnall's transcript further.

MR. BEEBE: We do not. This is news to me.

MR. BROOKS: I thought you said you did.

MR. BEEBE: No, we have nothing further to read from that. I wish I did, but I don't.

THE COURT: Do you think we can count on this gentleman by 1:30?

MR. BROOKS: We will try to reach him through his

mdh3

secretary at lunch. We just couldn't promise he will be here by then.

THE COURT: Ladies and gentleman, why don't we resume at 1:30. As you can see, we had matter of law this morning that caused readjustments in our morning schedule all around, and we therefore will recess now until 1:30, with the hope and expectation that our next witness will be available at that time.

(Luncheon recess to 1:30 P.M.)

AFTERNOON SESSION

1:30 P.M.

(In open court, jury present.)

THE COURT: Mr. Beebe.

MR. BEEBE: Mr. Arning is the next witness.

L E E D. A R N I N G, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BEEBE:

Q Mr. Arning, what is your present employment, please?

A I'm a general partner in Tucker Anthony & Day, 120 Broadway, New York City.

Q What kind of business is that?

A Member of the New York Stock Exchange and broker-dealers.

Q And were you in 1968 a vice president of the New York Stock Exchange?

A Yes, sir, I was.

Q Was that your title, vice president of the New York Stock Exchange?

A I believe it was in 1968, yes.

Q In 1969, sir, did you hold the same office?

A Yes.

Q Who did you report to as vice president of the New York Stock Exchange?

A I reported to the executive vice presieent, Mr. R. John Cunningham.

Q Did he in turn report to the president of the exchange?

A He did.

Q Who was at that time Robert Haack, I believe?

A Robert W. Haack.

Q Did certain departments in the exchange report to you?

A They did.

Q Could you name the departments that reported to you?

A Yes. The department of stock lists, the secretary's office, the department of member firms, the floor department, and I believe in 1968 the clearing corporation also.

Q And the chief examiner?

A Was part of the department of member firms.

Q Was Mr. Bishop the head of the department of member firms at that point?

A He was and still is.

Q And he reported to you at that point?

A Yes, he did.

Q Did you also report to the Board of Governors?

A As an officer of the exchange, yes.

Q Among other things, Mr. Arning, were you responsible for disciplinary proceedings involving member firms?

A The department of member firms was responsible for those actions and they reported to me.

Q Could you describe your duties with regard to disciplinary proceedings?

A Well, I guess my responsibility as the director of the department would have been to oversee whatever disciplinary actions were in process.

Q Was it part of your duty during the period 1967 to 1970 to recommend disciplinary proceedings when appropriat

A I don't think I had any unilateral recommendation to make but as part of the departments underneath me would make, I would probably be the one to make it to the chief executives of the exchange and to the board.

Q You gave a deposition in this matter on May 3, 1973. Do you recall that?

A I recall giving a deposition, yes.

Q I'd like to read you from page 10 this question and answer.

"Q Was it part of your duty during any period between the years 1967 and March of 1970 to recommend disciplinary proceedings against a firm such as McDonnell & Company?

"A Yes. You asked me what my duties were when I first became an officer and I told you that. Now, later on in 1967 with the change of administration from Mr. Funston to Mr. Haack I was named operations officer of the exchange. I was still vice president and in that capacity I took over the department I had earlier and I had responsibility relating to those."

That was your answer. Is that true?

A Yes. Sounds fine.

Q Now, in connection with disciplinary matters was the chain of command starting with the examiners who conducted an initial investigation and they in turn reported up through channels ultimately, in the appropriate cases, to the various committees of the Board of Governors?

A Well, you are generalizing, counselor. There were, I'm sure, disciplinary matters that did emanate from the examiners and went through a series of steps, yes.

Q Did you usually present the matters to the committees of the Board of Governors, which I think we have had testimony here about?

A In one form or another, yes.

Q Were you familiar with the rules and constitution of the New York Stock Exchange?

A I believe so, yes.

Q If I said that one time in prior testimony you answered that saying "Intimately," would that be consistent with your degree of --

A I think so. That was a year or so ago and I was more intimate with them then than today.

Q Good. That's why I may be reading some answers from here.

A That's very helpful.

Q Does the advisory committee of the Board of Governors have the authority delegated by the board, or did it at that time, to fine, censure, admonish or undertake a series of disciplinary acts with respect to member organizations, including instances of violations of Rule 325?

A The advisory committee had authority under the board construction to undertake disciplinary actions. I must say my memory is a little vague as to just what they were but they were rather substantial powers.

Q Did you regularly meet in this period, and by this period I mean from 1967 through March of 1970, did

you regularly meet with coordinators and examiners concerning firms that had problems?

A There were a variety of meetings with the department of member firms personnel, yes.

Q If I named Mr. Newman and Mr. Spies and Mr. Schuette, among others, were those people that you met with in that connection?

A Well, my recollection is I met in the main with Mr. Bishop and Mr. Stock and the senior officers of the department. But there were occasions when we met with the examiners and coordinators and other people as well, yes.

Q And those three that I have named, I also should add Mr. Stock, were four people whom you named in the prior deposition. What you are saying is that you did meet with those people in the course of those problems?

A At various times under various circumstances, yes.

Q Did you ever personally go in and examine a member firm that had difficulty during that period?

A Would you --

MR. BROOKS: Could we have a definition of what Mr. Beebe means by "examine"? Does he mean it is in an everyday sense or as an exchange examiner?

THE COURT: Yes, sustained.

Q Just to phrase that question slightly differently,

after examiners assembled the facts that they assembled, as we have seen testified here and was there doubt, did you ever go back and check on the particular facts that they drew out from their examination of the firm's books and recor

A By that, counsel, do you mean did I review their examination, audit their examination?

Q In effect, audit it by going back and checking against the books and records.

A No, sir.

Q You took what they gave you as the basic facts from the brokerage house that they were examining?

A If we were talking in terms of financial information, yes.

Q Did you once testify in to examin the books and records of a brokerage house is a little bit like a doctor who is able by examination to detect the health or lack of health of the patient, and that the staff examiners were the doctors in that analogy as far as the stock exchange is concerned?

A I may have.

Q Were you ever on the premises of McDonnell & Company in that period? All my questions are directed to that period.

A I'm not sure. I have been on the premises of

McDonnell & Company I think, yes. But I don't know exactly when. And not with any regularity. Perhaps once or twice at the most.

Q Or perhaps I should just read your answer a few years ago, which was on page 21, "I never recall being on the premises of McDonnell & Company at any time."

A I don't think that's totally correct. I think I have been on the premises.

Q Prior to 1973 when you gave this examination.

A I would think so, yes.

Q So to that extent the answer here was incorrect?

A Perhaps that' my recollection today is better.

Q Was it policy of the New York Stock Exchange to become concerned after a member firm passed a net capital ratio of 1,500 per cent?

A I think that's a correct statement. Among others I would think, too.

Q What are the others that come to mind as you are sitting here now?

A Well, I would think we were concerned about the areas of profitability and we were concerned about the makeup of capital as separate ingredients. We were probably also concerned with the makeup of both assets and liabilities.

Q When you say "makeup of capital," do you include

subordinated debt under that heading?

A In view of the fact that for purposes of Rule 325 subordinated capital was a part of the capitalization, yes.

Q Did you testify or is it true that the more subordination that is involved in a firm's capital the closer the exchange watches the situation?

A I'm not sure I really understand that. Can you gi me an example of some kind?

Q Well, you said that subordinated capital or subordinated debts is part of the makeup of the firm's capital. So what I am asking is, if there is a larger portion of subordination in that makeup, does the exchange at least watch the situation more closely?

A Well, I think what my first response was that the makeup of capital was an area we examined. If your question is if there was a disproportionate amount of subordination in terms of capital and something else, would that be an area of concern? I guess the answer to that is yes.

Q Now,we have heard some testimony, sir, about knowledgeability letters. And I think there has been some definition of what they are. Were knowledgeability letters a requirement for subordinated lenders during that period?

A No, I don't believe so.

Q Let me read you from your testimony a few years ago, if I may, starting on page 26.

"Q As we have seen, and I will show you later today, there are certain forms that are given to the New York Stock Exchange in the form of an application to the New York Stock Exchange to approve the person as a subordinated lender. My question to you is, what investigation, if any, was conducted by the New York Stock Exchange to see whether a subordinated lender had been informed of financial condition of the firm that it was about to subordinate to?

"A Well, the -- my recollection is, and these were never filed with me, always filed under department of member firms. The subordinated lender executed a letter agreement that he had the necessary financial information to reach the conclusion essential to his investment.

"Q Would that letter be considered in the vernacular a knowledgeability letter?

"A That is the term that is used.

"Q And the knowlegeability letter was a requirement of a subordinated lender?

"A I recall it, yes.

"Mr. Brooks: What time are you speaking?

"Mr. Dubin: Unless Mr. Arning corrects me, I am still speaking 1967 to March of 1970."

MR.BROOKS: Your Honor, I think the next two lines are very important.

THE COURT: Any objection to putting them in at this point?

MR. BEEBE: Glad to, sir.

The next one was, "Do you recall the specific instance when the knowledgeability letter became required?

"A I don't recall when it became required, no."

Q Were you referring then that you didn't know the exact date when it became required?

A Yes. I also thought your question now was materially different than the one I responded to a year or two ago, whenever that was. I was trying to be more graphic in an educational way rather than to a specific question.

Q I appreciate that, sir. I didn't mean to imply that you had said one thing now and another thing then. I was trying to amplify on it. Your testimony then is still your testimony now; is that true?

A Well, I just responded to your question that I don't believe it was then.

Q You say despite my reading this, as for the period 1967 to 1970, you now say that you don't believe

knowledgeability letters were required at that point?

A I don't believe they were, that's correct. I think it was later than that.

Q So when Mr. Dubin said "Unless Mr. Arning corrects me, I'm still speaking of 1967 to March 1970," there was nothing further said on this record?

A I guess my recollection is better today or else less better on that day. We made a material change in the knowledgeability at some point in time and I think it antedated this period you are speaking of. That's my best recollection -- rather postdated, I'm sorry.

MR. BROOKS: I object to counsel's suggestion that the deposition testimony --

THE COURT: Well, the deposition is in the record and any inferences can be argued and the jury's recollection of the evidence will govern.

Q Now, Mr. Arning, absent a knowledgeability letter, if there wasn't one given in a particular instance, did the exchange have any procedure that you know of as vice president at that time to inform potential lenders of the conditions of a member firm?

A No, it did not.

Q Another subject that there has been some testimony on here is the treatment of a potential

income tax refund as good capital under Rule 325.

Was a claim for an income tax refund ever considered good capital under Rule 325?

A I think there were circumstances in which income tax refund claims were recognized as good capital.

Q Was that a circumstance being after the brokerage house filed its claim and the government gave approval for payment and it was a matter of two or three weeks before the funds came out of Andover, Massachusetts?

A No.

Q Isn't that what you are alluding to?

A No.

Q Let me read you again from this sworn testimony two years ago.

"Q Well, let's put it in this context: do you recall an instance where an income tax refund which had not been physically received was allowed to be used as good capital or capital for the purposes of Rule 325?

"A Well, let me say this about that: I don't recall McDonnell per se. We did have, and I have a vivid recollection of many discussions about treatment of income tax refunds because in the year of 1969 and 1970, in particular a very healthy 1968, had given rise to

substantial earnings which were reversed in the next fiscal interval for many broker-dealers, which, as you can appreciate, resulted in a considerable number of firms having refund claims the following period. We had, loosely described, accepted a creditor status of United States Government Bureau of Internal Revenue Service as a good source of funds and the receivable arising from that for a period of time was accepted.

"And then in a series of discussions, part of which are vague in my mind but which I can recall having had in Washington with the SEC, the pripriety of the treatment of this was raised and I think my vivid recollection is more with Hayden Stone than anyone else. But we agreed at some point in time that until the government had agreed to pay them, there was a question as to whether or not it was going to be, and we made some point in time modification of the treatment."

Does that refresh your recollection?

A Well, my response was exactly what you just read: It's totally consistent.

Q Let me go on then.

"Next of McDonnell in this point of time but we did have a lot of work in tax.

"Q How were you to dtermine when the government

was going to pay?

"A Well --

"Q The tax refund?

"A I can tell you the later answer to that. I can't give it to you in point of time. But the funds, it seems to me, all came out of Andover, Massachusetts and when the government gave approval for the payment, which could have preceded the actual receipt of the fund by a period of two to three weeks is when we picked up at the latter stage was then deemed to be a good receivable."

Is that correct?

A Yes, and it's exactly what I just said, my testimony then and now is identical.

Q That it's a two to three-week period?

A No. Your question was at the time did we have any value given for income tax receivables, and I answered that, and it's on the record, that there was not -- we did allow it as good capital.

Then as you read my deposition you picked up that same answer but it then went forward from there, as I set forth in my deposition, as to what transpired later. That's exactly accurate, what was said then. It's in the record and you have a total picture.

At one time you had a different standard than at a later time.

Q Was there ever an MF circular issued that set forth the earlier standard?

A I have no recollection on that.

Q Was the earlier standard generalized, published, embodied in an amendment?

A I really don't know. You must appreciate, counselor, that tax law carry forwards are peculiar animals. They generate only when earnings and losses are in such a sequence as to make them existent. There could have well been a period of time when there was no such need for it. I really don't know.

Q Why did the SEC raise questions about the propriety of the treatment?

A I think you would have to ask them.

Q What did they tell you?

A I would prefer not to speculate on what the SEC said. I can describe for you what some of the problems were from our standpoint.

THE COURT: Please don't. The question is what did they tell you. I take it you are not in a position to answer that.

THE WITNESS: Yes, sir.

THE COURT: Next question.

Q Well, in your reference to the SEC in your answer here, can it be summarized by saying that the SEC opposed and disagreed with the stock exchange position?

MR. BROOKS: I object to the question.

THE COURT: Sustained.

Q There has also been testimony, sir, about a time in 1969 when McDonnell & Copany was negotiating with Scheinman, Hochstein & Trotta for the sale of a managing fund.

Under Rule 325 was it necessary to finalize that transaction in some way before the proceeds of the sale would be considered good capital?

A There would have to be a transfer of title, I would assume. Somebody would have to own an asset before they had value for it.

Q And before that it wouldn't be considered good capital under Rule 325?

A Your word "finalized" is difficult for me to deal with. I don't know what the transaction today and I think I would be guessing.

Q Sir, I am going to ask you some questions starting early in 1968 and perhaps slightly into 1967, then moving forward chronologically. From your vantage

point as a vice president of the exchange, we have already gone over some of these areas in terms of the examiners and coordinators.

First I am going to ask you, starting in March of 1968, whether a memorandum was issued by the department of member firms to managing partners and officers of member organizations regarding, among other subjects, possible restrictions on business because of serious rycord keepint problems?

(Plaintiffs' Exhibit 78 was marked for identification)

Q I show you Exhibit 78 for identification.

(Pause)

MR. BROOKS: I have no objection.

MR. BEEBE: Offer that in evidence.

THE COURT: Received.

(PLaintiffs' Exhibit 78 was received in evidence)

Q After appraising the large number of member organizations who had effectively coped with the operations problems brought about by sustained volume, the memo states:

"There have, however, also been a disturbing minority of member organizations requesting several

extensions for completing regular and special financial questionnaires. Serious operations problems have been found by auditors and examiners."

My first question is, sir, was McDonnell & Company, as far as you remember, one of the firms requesting several extensions for completion of its regular 1967 questionnaire?

A I don't know.

Q I would like to show you two documents that were mareked in evidence as Exhibits 68 and 70, and ask you if that will refresh your recollection.

(Witness reads)

Q Does that refresh your recollection that McDonnell & Company was one of those requesting extensions?

A It doesn't help my recollection. It's fact they did ask for an extension.

Q I believe we have had testimony that Exhibit 70, Mr. Greves' testiried, indicated four extensions and number five itself was the -- the exhibit itself was the granting of a fifth extansion.

(Witness reads)

Q Did five extensions qualify McDonnell as one of the disturbing minority member organizations requesting several extensions?

MR. BROOKS: I am going to object.

THE COURT: Sustained.

Q Sir, you saw the March 14, 1968 memo we have marked as Exhibit 78 before it went out, did you not?

A I would think so, yes. Not certainly, but probably.

Q That's the type of memo that would require your approval before it went out at that time: is that right?

A I think probably that's correct.

Q Was McDonnell & Company restricted in March 1968 by the stock exchange?

A I have no recollection.

Q I show you a letter dated March 18, 1968.

MR. BEEBE: I will ask that to be marked as Exhibit No. 79 for identification.

(Plaintiffs' Exhibit 79 was marked for identification)

MR. BEEB E: I offer that in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 79 was received in evidence)

MR. BEEBE: I would like to read from it, if I may, your Honor.

THE COURT: Yes.

(Mr. Beebe read to the jury from Plaintiffs' Exhi-it 79 in evidence)

Q Is it fair to say this is a restriction letter?

A Yes, it certainly is.

Q Going back to March 14, the letter which went out to all member firms, and discussed possible restrictions of business because of serious record keeping problems, it stated, after reciting this part

we went over earlier, that"it consequently seems timely to make all member organizations aware of actions which the exchange may take in such instances."

Then it discusses the possibility of limiting the growth of the firm's business when a member appears to be in danger of losing control of the records, restricting the approval of new registered representatives, branch offices, underwritings, perhaps even selling branches, and so on.

Were these the kind of restrictions that the stock exchange used when brokerage houses had serious operation problems?

A I think that is exactly what it says, yes.

Q The last paragraph of that March 14, 1968 memo, the last paragraph on the first page warns that it's unwise to undertake full conversion to a new system of record keeping until it's clearly established that daily accomplishment of all firm business can be maintained on a current basis producing accurate balance records.

Then if I can turn to the restriction letter four days later to McDonnell & Company it states, it points out, to McDonnell & Company, from the exchange, that "You are planning a change in computer equipment

during the spring. Our experience is that firms approaching a conversion should make sure that their records are in excellent order before the conversion begins."

Shortly thereafter, sir, did McDonnell & Company launch an attempted conversion of its record keeping, using a new computer system?

A I don't know when they did it, but they did convert to a different computer operation, yes.

Q Was that conversion successful at that time?

A I think that is a difficult question to answer. I don't think I am qualified.

Q On page 58 some years ago you expressed an answer to a question "Do you recall how these conversions progressed?

"A I have no recollection of them while they were going on. My offhand view is that every conversion they had was a disaster."

Is that your recollection?

A Yes. And what was your question you just asked?

Q Whether the conversation was successful, sir, did McDonnell & Company use the firm of Data Architects in their attempted computer conversions? Does the name

ring a bell?

A Yes, it rings a bell, but I don't know in what way. They were a data processing operation of some type.

Q Were they a software house?

A I would think so.

Q Do you know if McDonnell & Company in its corporate capacity also had an interest in the firm of Data Architects at that time?

A I can't speak as to the time, but there was some Data Architects stock that was there later on, I know.

Q Again remding you from your testimony, page 59:

"Do you recall it" -- Data Architect -- "in connection with McDonnell & Company?

"A Yes. They owned a piece of it. They had some stock, it seems to me, of Architect. They still have it."

That is a little further along the lines you just testified.

Did the exchange send a letter to the McDonnell Company after imposing the -- after the first letter which was a restriction letter which imposed

more detailed restrictions on McDonnell Company in 1968?

A I don't recall.

Q I show you an April 2 letter. We are trying to get one that has a complete left side on it. We don't have one with a complete left side.

MR. BEEBE: I ask that be marked for identification, and I offer it.

(Plaintiffs' Exhibit 80 was marked for identification)

MR. BROOKS: Your Honor, I concede this is a genuine document form thefiles of the stock exchange. Both of the lats two exhibits were letters written by somebody else. I wonder whether there is a foundation to introduce it through this witness.

MR. BEEBE: There was testimony at the deposition using this document.

THE COURT: All right. Overruled.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 80 was received in evidence)

Q Sir, you approved of the imposition of restrictions before they were actually imposed. Was that your normal procedure at that time?

A No, I don't think so.

Q Pages 63 and 64 of your deposition -- have you had a chance to review your deposition recently?

A No, I haven't.

Q "Q And again I believe your testimony was you would have had to approve a restriction or a lifting of a restriction?

"A Yes. But in fairness to Bob (Bob Bishop) I think there was an earlier restriction imposed and he could well have modified this based on information available to him. It's possible I didn't see it or know about it before it went out."

A If you are interested in what the policy of the exchange was I am sure there were occasions Mr. Bishop levied restrictions that I did not know of at the moment he did it. I am sure in the performing of his function he would notify me. I would know about them, there is no question about them, but there certainly were times I wasn't available and Mr. Bishop is an excellent executive and he would act when I wasn't available and let me know.

MR. BEEBE: I move to strike the last part as to Mr. Bishop's qualifications as not responsive. I don't believe it belongs in the record.

THE COURT: What was the question asked?

(Record read)

THE COURT: I will allow it to stand.

Q Would it be fair to say about these restrictions that they were designed to reduce the strain on the firm's bookkeeping? Would that be a fair summary?

A No, I don't think I would say it that way.

Q How would you say they were designed?

A I would say they were designed to allow the work force to be put to clearing up whatever the problem areas that were identified.

Q The first page, the third paragraph mentioned that approval of registered representative transfers wouldn't be made for the "foreseeable future."

Could you translate that into a general time frame? Is that a matter of months, weeks, days?

A No, I can't.

Q Can you give us a general idea of what is intended by "foreseeable future" in terms of restricting representative transfers at that time?

A I will speculate that --

THE COURT: No, do not speculate, sir.

MR. BEEBE: I am afraid you can't do that.

Q You are unable to testify at this point?

THE COURT: Mr. Beebe, the additional problem is he didn't write the letter.

MR. BEEBE: He either approved it at that time or shortly thereafter as I understand it.

THE COURT: But he still didn't write it.

MR. BROOKS: He testified he would have either known or been informed about the restrictions.

THE COURT: In any event, the objection is sustained

Q How long did those restrictions remain in force?

A I have no idea.

Q I show you a letter dated April 19, 1968 (handing to witness).

MR. BEEBE: Will you mark that as the next exhibit for identification, please.

(Plaintiffs' Exhibit 81 marked for identification.)

Q Does that letter remind you that the restrictions were lifted 17 days later?

A Yes, it does.

Q Do you know if the restrictions were reimposed at any time after that in 1968 on McDonnell & Co., or any other restrictions?

A No, I don't.

Q Sir, did McDonnell & Co., during the summer of 1968 -- we have had testimony that McDonnell & Co. during that summer reported its financial condition on a regular basis to the exchange, or reported what it said was its financial condition.

MR. BROOKS: I object to the characterization.

THE COURT: Attorney's comments are not evidence, and the jury has been instructed as to that many times.

MR. BEEBE: I am reminded I should offer 81 in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 81 received in evidence.)

(Plaintiffs' Exhibit 82 marked for identification.)

MR. BEEBE: I offer Plaintiffs' Exhibit 82 in evidence.

MR. BROOKS: Again, your Honor, I concede that it is a genuine document from the files of the exchange. Again, it is not either written by or addressed to this witness.

MR. BEEBE: Again there was examination at the deposition on this using this very document with this very witness.

MR. BROOKS: I have no objection.

THE COURT: Received.

(Plaintiffs' Exhibit 82 received in evidence.)

Q Sir, this document addresses itself in part-- I direct your attention to the last paragraph to the subject of fails to receive.

I believe the indication is that the fails to receive as of June 27th at McDonnell & Company were of the magnitude of $29,783,000.

There is also reference to a mandatory buy-in.

Could you first explain what the mandatory buy-in procedure was at that time in simple terms, if possible?

A Yes. I am sure that the jury has had some background here. I am not aware of what they have had with street terminology, but I will make the assumption that some of these terms will not confuse them, and if I am wrong you will just have to interrupt me.

Q Very well.

A The delivery process on the street suffered from many difficulties, in part from the transfer area, but in any event the flow of securities to settle customer

transactions did not have a velocity that was helping resolve these difficulties, and the ad hoc committee of the industry, which contained both the New York Stock Exchange, American Stock Exchange, NASD --

Q Excuse me, I will accept your offer to interrupt you a little bit. I am interested in the narrow question pending, what the mandatory buy-in procedure was, and particularly in terms of the fails to deliver, how it related to aging and fails to deliver.

THE COURT: I take it he was trying to explain the fails to deliver as a foundation to going on to the other.

THE WITNESS: I was.

THE COURT: I think that would be helpful to us. Go ahead.

THE WITNESS: Could you tell me where I was, please?

(Record read.)

A -- enacted or caused the exchanges to enact the rule which provided that at the expiration of a fixed period of time, and I think for listed securities it was 30 days, if the contract had not been satisfied by a physical delivery of securities the broker that was due to receive the property would buy-in the contract on the floor of the stock exchange, that is enter into a new trade, and

accomplish the delivery of that certificate that they had been failed to receive thus far.

That rule was one of a number the exchange put in that worked very well. You will appreciate, I am sure, that what one broker is failing to receive another one is failing to deliver.

THE COURT: Mr. Arning, if I may step in, I don't think there has been any testimony whatsoever as to how a transaction is accomplished. There is a seven-day delivery period, is there not?

THE WITNESS: If it please your Honor, it is five days, but it is really a week.

THE COURT: Tell us about that. This is a foundation actually for what you were saying just now. A customer buys a security from broker X.

THE WITNESS: Today?

THE COURT: Today. And that broker through the floor of the exchange buys that from broker Y. There is the five-day rule which you say in practice is a week.

THE WITNESS: A calendar week.

THE COURT: For broker Y to deliver the security and broker X to make the payment for the security delivered, right?

THE WITNESS: Yes, sir.

THE COURT: What you are saying here is if that doesn't come to pass within 30 days at this point for one reason or another the buying broker had to go out and buy all over again, is that right?

THE WITNESS: That's correct.

Q So he was out of pocket twice for the same set of securities, is that right?

A No, no. The failing broker has the market risk. To explain that a little bit, the broker who had failed to deliver the securities has the exposure, and when I go out and buy the stock back and paid more, I bought it at 25 and 30 days later it costs me 27, the $2 a share difference has to come from the broker who failed to complete his contract.

Q In this point of time we are focusing on, the letter indicates the fail to deliver items were 27,200,000, and then it says that it is worth commenting, according to the McDonnell Company, to the exchange, that they had reduced their fail to deliver items down to 23,000,000, and their fail to receive items I guess had gone up to $30,000,000.

My question is: in order of magnitude, were those fails, did those represent substantial fails or were those the kind in the order of magnitude that was customary

and common at that time?

A Your Honor, that is a very difficult question. I would like to explain why it is difficult. Those numbers are very large numbers, there is just no way to describe them any different.

Q Yes, they were large.

A But I suspect that the daily settlements that went through McDonnell & Company were approximately that same amount of dollars. So you are talking about one day's transactions. I don't know what they were processing, counselor. I am approximating. The daily through put in a broker-dealer of the size of McDonnell & Company was very substantial, and their daily settlements could well have been 30, 40, 50 million dollars, in which event the amounts failed to be delivered are equivalent to one day's transactions.

THE COURT: A month?

THE WITNESS: A single day. The aggregate I would say were easily $30,000,000. So the answer is both yes and no.

Q There was another subject I will kind of interject here that we talked about, which was box counts. There has been some testimony about box counts. Was it good business practice to have a complete box count at more than the

annual rate -- in other words, more than once a year?

A We believed at the exchange, yes, that it was good business practice to do it more often than once a year.

Q We move ahead to October, 1968, and the subject of arbitrage. I show you Exhibit 60, which has previously been marked in evidence. That is from Hank Newman to W.E. Jones, I believe the testimony has indicated.

Did the exchange examiners recommend Rule 325 be amended to avoid a violation of the rule with regard to McDonnell & Company's arbitrage transactions?

A I really don't -- I recall a lot about this, but I don't recall whether they recommended to change the rule or not. It is clear Mr. Newman thought they should. I can't quarrel with that.

Q Now, instead of amending the rule was something else done which allowed McDonnell to have the interpretation it wanted about arbitrage transactions?

A Well, your Honor, this again is a highly technical application of exchange rules which I would be delighted to go into in detail. If somebody doesn't want me to, please interrupt.

McDonnell was a specialist and it is a very different animal as a specialist, where it had an affirmative obligation to make a market in the securities, the rights market.

Ladies and gentlemen, on the floor of the exchange, we separated the specialist for rights. A right to subscribe is a medium that many issuing companies utilize to attract additional -- sell additional shares, and an existing stockholder would receive a right, for 10, 20, and that together with other rights, a total of 25 would be necessary to buy 1 share of stock at a price probably reduced from the prevailing price on the floor of the New York Stock Exchange. Not everyone wished to sell their rights. They had value. Between the prevailing market price of the security and whatever the exercise price of the right might be, divided by however many rights there would be to buy the security.

We had to market in these rights because people wished to sell them. You could buy them on the floor, whether it was telephone or any other kind of offering, without having owned the stock. So we had a specialist on the floor of the stock exchange uniquely constructed to make a market in the right. Whatever security, it didn't matter whether it was a utility company or industrial company, the rights were always conducted on the floor of the exchange in a market environment conducted by McDonnell & Company. It was obliged in that single function of its affairs to comply with the rules relating to specialists.

What I mean by that simply is it must make a concurrent bid and offer in the market. It had to make the rights market. It could not leave the public without an opportunity to buy or sell those rights. In fact if there was no rights being offered, they would have to offer them even if they offered them short. If there was no bid, it had to be a McDonnell bid to maintain that market.

I recall that when the issue came to me the question of whether the offsetting position that McDonnell had created in the common stock against its purchase of rights would be interpreted as an arbitrage matter in the 325 application or whether there was some other way to look at

this. What I recall about that is -- and you must appreciate also at one time prior to this I had run the floor department of the exchange -- that the specialist function, which was the public side of this, overrode any earlier consideration 325 may have had when in fact it was never constructed to contemplate this issue. And I ruled -- I interpreted 325 in a manner that would permit McDonnell as rights specialists to perform its specialist function as it was obliged to do under specialist rules. If it entailed buying rights at the offsetting sale of the equivalent amount of common stock, it was not the old type arbitrage. And this was the matter that came to me and that's the manner in which I ruled.

Q Thank you, sir. This memorandum that I put in front of you from Mr. Newman to Mr. Jones is reciting a telephone conversation in part with Mr. McKay.

"I also told him that any proposed amendment would have to be cleared with the SEC. He was not at all happy about having the SEC know of the proposal if made."

The next sentence is, "Why don't they bring in more capital?"

As a result of your ruling or interpretation of Rule 325, as you have just called it, was McDonnell & Company not obliged to bring any more capital in?

A I don't really recall what the capital status was at that point.

Q Sir, was McDonnell & Company's bookkeeping process at that point in good condition, bad condition, do you know what condition it was in?

MR. BROOKS: Mr. Beebe, do you mean the date of the memo, Exhibit 60, when you say "that point"?

MR. BEEBE: Let me see if I can pinpoint an exact time for you.

Q Let me ask you as of, say, October, 1968, what was your view at that point as to McDonnell's bookkeeping processing, good, bad, indifferent, you don't know?

A I really don't know.

Q Was it your view at that time that McDonnell & Company needed more capital?

A Again I really don't know.

Q Now, moving ahead a month or a little less, into November, 1968, I show you a memo which I believe has been marked in evidence. I am trying to find out the number right now.

(Pause)

Q Did you know in November, 1968, that McDonnell & Company had lost seven or eight vice presidents since the death of Sean McDonnell?

A No, I didn't.

MR. BROOKS: Your Honor, I object to the form of the question because the memo only suggests that somebody told somebody that they had lost them.

THE COURT: The answer was he didn't know that. Let's go on.

Q Did you know if they had lost some senior management people at McDonnell & Company since Sean McDonnell died in the summer of 1968?

A I'm not aware of any loss of senior management people, as you put it, other than the later untimely death of Tom McKay. You must appreciate in a corporation, which I think this was at that time, vice presidents are vast in number. Many of them were producers and their ability to move about was well known. Even if I had known it I doubt if it would have meant anything to me.

Q We now have a document number 35A and it has an attached memorandum to the covering memorandum, but I am not addressing my questions to the attachment but just to the covering memo.

Now, I just want to make sure that is in evidence before I read from it. I believe we had testimony that was a memorandum from Mr. Bishop to Mr. Schuette in part stating, "McDonnell's operation and control are therefore

said to be declining rapidly."

Were you aware at that time of such a condition of McDonnell & Company?

A I wasn't aware that someone felt thatway I recall, no.

Q Did you feel late in 1968, without pinpointing it to a particular day, that McDonnell & Company's operations were declining rapidly?

A Well, I don't want to complicate your interrogation here. I do want to be as precise as my recollection permits me to be. The volume levels thatwe had in 1967 prevailed for most of 1968, and my recollection is that the exchange and Lee Arning in particular had a concern about McDonnell and other firms like it in terms of ability to process information. That is certainly so.

Q And that concern existed late in '68, I take it is the thrust of your answer?

A Yes. I thinkthe continued activity brought that to the fore.

Q Sir, I asked you a minute ago about whether you could characterize their bookkeeping processes at that time. I would like you to answer that question. I think I withdrew it.

A I think I just responded in a total way, did I not?

Q In your deposition you were asked for your opinion as to whether McDonnell & Company needed capital. It is the bottom of 80 and 81. I think that may be a part of your answer there.

The answer is, "I am going to answer it this way: We don't have the data here, unless you have their X17A5s or an examiner's report. My -- I don't know. My tuess is these people were bearing substantial capital charges arising out of the lousiest bookkeeping process, and if they didn't have those they would have had plenty of capital.

That was your view at the time, was it not, they had one of the lousiest bookkeeping processes?

A I think the question is significantly different.

Q I'm focusing on your view --

THE COURT: I think you had better put the question in the deposition.

It was question in the deposition you are saying?

THE WITNESS: The one in the deposition had a different response than the current one because I think there were two questions asked.

MR. BEEBE: I will put the question in the deposition.

THE COURT: Please do.

Q "Q Was it your opinion that the firm of McDonnell & Company at that time needed more capital?"

A This time period, sir, is what?

Q October '68 was the question. In fact, the question right up the page answers that.

"No, we are talking about this period of time being October of 1968."

Your mind is working the same as it did then. You answered it the same way:

"Mr. Brooks: If you had such an opinion.

"Q Of course if you had such an opinion at that time, this is October 1968. You have given me two varying interpretations as to high capital ratios

BEST COPY AVAILABLE

either being an effective use of the capital on hand or poor use of it."

THen came your answer which we already have.

A I hate like heck to ask this but would you read the question?

Q That was the question.

A That was the whole question?

Q Yes.

A Would you be good enough to read my response to the deposition?

Q Certainly, sir.

"I am going to answer that this way: We don't have the data here unless you have Share X17A5's or an examiner's report. My -- I don't know. My guess is these people were bearing substantial capital charges arising out of the lousiest bookeeping process, and if they didn't have those they would have plenty of capital."

Do you want to change that answer in any way?

A No. I will let it stand if I may.

Q Let me ask you right here, am I correct that it relates to a bookeeping process which was poor at that point with capital problems? If they hadn't had poor bookeeping they wouldn't have had as many

BEST COPY AVAILABLE

capital problems?

A Yes. My problem is not so much that single response as the whole background to the earlier deposition when I was roaming, I think, and trying to be helpful over a wide range of areas that were, I thought, pertinent to this. When that gets picked out -- I think we are all human. I would probably say it a little differently today but it's not inaccurate.

Q Sir, if I could come back to the memo about the loss of seven to eight vice presidents --

A I hope it was seven.

Q Seven to eight.

A I thought you said 70. I'm sorry.

Q No, seven to eight. I know there are a lot of vice presidents in this world but that would be a record.

Sir, you were aware, were you not, that there had been a series of hardships that befell McDonnell & Company in late 1968 in terms of loss of personnel; is that right?

A Yes, you are absolutely correct.

Q And that those disastrous losses of personnel by death injured McDonnell & Company in its operations is that right, sir, in late 1968?

A Well, it certainly stripped them of some senior skilled management at a time when one could ill afford that sort of thing.

Q Do you recall that McDonnell's 1968 audit, which was due late in that year, again was delayed like the 1967 one had been?

A I dind't.

Q We have had testimony, I believe, from Mr. Schuette that he learned in early or mid January from Mr. McKay that the audit was finally completed, that the firm was going to need $1.7 million to bring its ratio up to 2000 per cent, and 2.3 million to arrive at 1500 per cent, which I believe you testified was a level of concern, 1500 per cent ratio.

My question is did you learn of that information shortly after Mr. Schuette learned it? Did it come immediately up the ranks?

A Well, I would think so but I have no recollection as to what happened.

Q Do you have a recollection that at that point in mid-January 1969, that McDonnell & Company had a serious capital problem?

A At this point I 'm just not sure.

Q Pages 98 and 99 of your testimony read:

Were you aware of the contents that the firm of McDonnell & Company was over almost $2 million" --

A The contents?

Q I'm reading it literally. I'm not sure how it works grammatically. In fact, I'm sure it doesn't work out grammatically.

The transcript reads:

"Were you aware of the contents that the firm of McDonnell & Company was over almost $2 million and the 2000 per cent limitation?

"A I think I testified I recall that they had a capital problem at the end of their 1968 audit.

"Q Would you consider $2 million a considerable capital problem?

"A Yes, sure. "

A I will stand on that reply.

Q Did you once compare a violation -- and I mean this in sworn testimony -- a violation of Rule 325 to a driver exceeding the speed limit? In other words, it's worse to go over 80 miles an hour than to speed at 72 miles an hour, but the risk is no good in either case.

Do you recall making that comparison?

A No. But you confuse me very substantially.

Q Why don't I read the question and answer from the transcript.

"Q Do you consider a viclation of rule 325 to be placed in varying degrees as to egregiousness of the violations? By that I mean is the violation of 3000 per cent as compared to 2000 and 1 per cent a more egregious violation or is it that any violation has the same weight?

"A Well, it's worse to go 80 miles an hour than at 72. I suppose there is a degree of difference. If the bottom line is your exposing the customer's property that is on your books to a greater degree than other witnesses, it can't go good."

A Sounds like an Arningism. I'll buy it. I didn't recall having made it.

Q Moving on, sir, to the end of January 1969. Is it safe to say that as soon as the examiners learn of the violation of the net capital rule as reported by the auditors in this surprise audit that we have heard about, if a violation comes out of that, that that information immediately goes up the chain of command to the higherups?

A We don't have a surprise audit. We have a surprise examination. If you are referring to the exchange

visit where the examiners could conduct it, do their analysis and come up with a finding where there was a capital violation; yes, I'm sure the wheels of departments worked so that that information was passed along.

Q Thank you for that. I was really driving at the surprise audit, though, which Lybrand would conduct.

A I beg your pardon. I didn't grasp it.

Q Let's move on to the Lybrand one. When you have an outside auditor who comes in once a year; is that right?

A Yes, independent review.

Q When they come back with the report, which we have had testimony in this case that it was delayed, when they come back with their report, if their report indicates a capital violation does that information immediately flash up the chain of command to the higher ups, yourself included?

A Same as the other one, surely.

Q Was a charging memo issued with regard to McDonnell & Company?

A I didn't get the term.

Q Charging memo.

A I suspect you mean a charge memorandum.

Q Charge memorandum.

A Where charges were brought against someone, is that what you are speaking of?

Q Yes.

A And the question was was one brought against McDonnell?

Q Yes, and a charge memorandum issued against McDonnell & Company.

A I can't be specific in my recollection.

Q Well, in the procedure when a charge memorandum is brought or issued, does it represent the exchange's final determination as to a firm's capital position at the time involved?

A Well, it might or it might not. It should but there are circumstances where it might not.

Q You were shown a charge memorandum at your deposition regarding McDonnell & Company when you asked the questionner whether there was one. You said, "What does the charge say on McDonnell? That would give a final clue. That is it."

Then you were handed it

"Q There is a charge memorandum.

"A It has the amount of capital?

"Q At various instances.

"A Okay, that is it, go by that document.

"Q That would be your final determination?

"A Absolutely."

A I stand by that.

THE COURT: We will take our recess at this point.

(Recess)

(In open court; jury present)

Q Let's start right in, Mr. Arning, if we may. Before the break we had gotten up to the end of January 1969, the latter part of thatmonth. Was McDonnell & Company in apparent violation of the net capital rule by that point?

A Well, sir, I've lost the trail here. What were the facts in January?

Q What exhibits do you have in front of you? I will see how up to date you are.

THE COURT: Mr. Arning, let me ask you this: As you sit here today, do you have any independent recollection as to what the capital position of McDonnell was in January or February of 1969?

THE WITNESS: No, sir, I do not.

THE COURT: Why don't you show him the exhibit which I take it is the basis for going on to something else, Mr. Beebe. Show him that exhibit. He doesn't have any recollection at all. I just don't see any point in putting an exhibit before him if he is then going to parrot what's in the exhibit. Show him an exhibit, and then go on to the next question.

MR. BEEBE: I wasn't planning to have him parrot an exhibit at all. I was going to ask him

what he had been informed by people in the exchange who already testified here, and the evidence is before this court, as to what was known and not known in the exchange. He testified just before the break that naturally if there was a violation reported this would speedily come up.

THE COURT: I anticipate where you are going, and I felt we should explore whether this is looking at a document or whether this is his recollection. He says he has no recollection of their capital position in January or February of 1969. Give him that. If you want to explore what the fact was, and what lookingat that he may have done, based upon that you get something.

MR. BEEBE: I was not planning to show him an exhibit and having him recite from that, or anything like that. Let me take another approach, if I may.

Q Sir, when an apparent violation is reported to you at that time, the end of 1968, beginning of 1969 -- and I am talking about an apparent net capital violation -- do you take steps to determine whether or not there was indeed a real net capital violation?

MR. BROOKS: Is the question addressed to

Mr. Arning personally or as to the exchange as an organization?

THE COURT: Him personally, I assume.

MR. BEEBE: Naturally, to himself and his operation, the operating procedure at that time.

A My difficulty, sir, is the construction. I don't audit independently a capital review that comes out of one of my departments. If I can say it for you, if I were advised -- this is general and nothing to do with McDonnell -- have a capital violation of a member organization I would get the details as to the degree of the violation and all the information I could about it.

Q We were talking about a charging memorandum -- a charge memorandum, I believe you corrected me -- before the break.

I show you a document which has been marked at the deposition as Exhibit 133, Plaintiffs' Exhibit 133. It is dated October 22, 1970.

MR. BEEBE: I ask that be marked as the next document for the plaintiff.

(Plaintiffs' Exhibit No. 83 was marked for identification)

MR. BEEBE: It is addressed to the board of

governors from the department of member firms, McDonnell & Company, Inc., and T. Murray McDonnell. The subject is stated to be "Statement of facts and offer of consent by McDonnell & Company, Inc., and T. Murray McDonnell for violations of exchange rule 325." It is, I would estimate, 15 pages long. I offer that in evidence.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 83 was received in evidence)

Q Is this the statement of facts and consent with regard to McDonnell & Company?

A On date of October 22, 1970, yes, sir, certainly this appears to be.

Q Is that what you referred to earlier as a charge memorandum, in this case also incorporated in a consent?

A Yes, sir. I think that is the term I would use for it.

Q Do the facts recited in the charge memorandum, under the heading "Statement of facts" on the first page, sir, normally include the exchange's final determination of violations?

A Yes.

MR. BEEBE: I would like to read from Exhibit 83 violations of capital rule. After a prefatory paragraph about the rule --

MR. BROOKS: Which exhibit?

(Mr. Beebe read to the jury from Plaintiffs' Exhibit 83 in evidence)

Q By analysis, I take it they mean an analysis by the exchange in that exhibit?

A Yes.

MR. BEEBE: There are also exhibits attached hereto regarding other violations. I would just summarize them and say according to the subject matter and the exhibits attached they covered books and records, which is Rule 440 of the exchange, and SEC Rule 17(a)(3), Rule 417.11 regarding audits, Rule 402 and an SEC rule regarding segregation of securities and Rule 342 regarding supervision and control.

Q Sir, do you know why this charge and consent are dated October 22, 1970, when from earlier testimony we know that McDonnell went into liquidation in March, 1970, and we also have evidence in the facts recited in here that McDonnell & Company was in violation of the rules in January, 1969?

The thrust of my question is: can you explain why it took so long for the charges to become in final form?

A I don't know that that is that long. What was the date that the firm went into liquidation?

Q March, 1970, and the violations, according to this document, occurred -- well, in the statement of facts it refers --

THE COURT: Mr. Beeve, I think it inappropriate to have this colloquy with the witness.

MR. BEEBE: I apologize. I was answering his question.

THE COURT: Go on to your next question, please.

Q Will you explain what Rule 417 related to, with this recitation there was a violation of here in the finding?

MR. BROOKS: Your Honor, the rule is in evidence. It is about the best evidence as to what it relates to.

THE COURT: Mr. Beebe, what do you want to get to that is not already in Exhibit 83?

MR. BEEBE: A general statement as to how the audit rule applies and how a violation of that rule applies to this situation, since this is not something that has been covered as yet at the trial. Just a brief statement.

THE COURT: All right. Go ahead.

A And the question was?

Q The question was, sir: could you explain the audit rule that this memorandum found was violated?

A Well, I will do this from recollection. I believe Rule 417 sets the standards for the independent review by accountants of the firm's books and records. It has the audit scope, and a lot of other detail in it, and from just a quick scan of this I think the violation was the delay aspect.

Q Do you recall in January, 1969, that the exchange was contemplating amending its constitution?

MR. BEEBE: I will ask this to be marked as the next plaintiffs' exhibit number.

(Plaintiffs' Exhibit 84 marked for identification.)

Q I show you a special members bulletin dated January 16, 1969, addressed to "All Allied Members," on the subject of "Proposed amendments to constitution on rules and matters of discipline, suspension and reinstatement

of members, allied members and member organizations."

The question is, sir, do you recall that?

A This special membership bulletin evokes a recollection, sir.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 84 received in evidence.)

Q As a result of that proposal in the middle of January, 1969, by the exchange, was the exchange constitution indeed amended to add article 13, or add to article 13 regarding the suspension of firms?

A I see changes to article 3 and article 14.

Q I direct your attention to proposition D, which is four pages from the end, and the discussion --

A I have 9, 12 and 15 yhere. You said 13?

Q Yes, sir. I was referring to four pages from the end.

A I'm sorry, I see 13. I am with you.

Q As I recall from your prior testimony you were actually quite close to this whole amendment process, were you not?

A I don't know what that means. I guess I was involved in anything coming out of the department of member firms.

Q Could you explain the genesis of this amendment?

A I would speculate that in the member--

Q No, please, sir.

A Can I read from the member bulletin that describes why?

Q If you have nothing independent from that--

A I think the reasons for this were abundantly clear and when you have a membership organization that has to vote you make it clear to them, and I don't think I could add to that.

Q Very good, sir.

How did the suspension process work under the amendments which became effective, I believe, on January 30th

A How did they work?

Q Yes. How did it work procedurally?

A I am sure the amendment here would set forth the mechanics for it.

Q Do you know of any firm that was suspended in 1968 under the procedures of article 13?

A Well, these I don't think went into effect until 1969 so there couldn't have been any in 1968.

Q I'm sorry. I meant 1969. You are right.

A I have no recollection.

Q Of any firm being suspended in that year 1969?

A Right.

Q I asked you whether you recall whether McDonnell & Company was in violation in January, 1969, of the net capital rule. Was there a procedure for submitting apparent violations or findings of apparent violation to the advisory committee of the Board of Governors? I believe you alluded to it earlier.

A Well, the advisory committee would have been a route for the presentation of a violation, yes.

Q What other route was there?

A Directly to the board in trial form.

Q Was the only question as of January, 1969, whether or not the charges would be brought?

MR. BROOKS: I object to the question, your Honor.

THE COURT: Yes. Sustained.

Q After the report of apparent violations in January, 1969 -- let me read you, in terms of your having testified that you didn't recall whether there was a violation in January of 1969, from page 127 of your deposition:

"Q Were you aware of that situation" --

THE COURT: Mr. Beebe, your question to him was whether as he sat here he had an independent recollection of that fact.

MR. BEEBE: Which he didn't.

THE COURT: That is different from the way you put

the question to him now in summing it up.

MR. BEEBE: Let me start again.

THE COURT: You said he didn't recall. That wasn't his answer. His answer was he has no independent recollectio

Q Referring to page 127, the question starting "Then what the situation is, that upon determination by the New York Stock Exchange of the violation --

"A I think that has been determined here."

Mr. Brooks then interjects.

"By the staff."

"The Witness: The staff determined the violation of 325.

"Q Going to the advisory committee for its action?

"A Right.

"Q Were you aware of that situation back in February of 1969?

"A I was aware of the fact they had a capital violation. I testified to that The only outcome was charges."

MR. BROOKS: Your Honor, I think the reading is unfair unless it also shows that on page 124 of the deposition transcript Mr. Arning had just at that time been shown what has become Trial Exhibit 74 in this proceedin

which is Mr. Spies' letter to McDonnell discussing the capital violation. I think if he shows that to him again we can make some headway.

MR. BEEBE: I belive the testimony was perfectly clear, but here is Exhibit 74.

THE COURT: Mr. Beeve, it doesn't make a particle of difference in the examination.

MR. BEEBE: I don't think so, either.

THE COURT: I think you were trying to establish at another time he had a recollection which he doesn't have today, and Mr. Brooks is saying at that time he was shown an exhibit which I assume refreshed his recollection. That's what the position was on an overall reading. Does it for your purpose make a difference whether he has an independent recollection today or not? Isn't it a question of knowing what the facts are in January as can be established from letters or reports, what did he do or what did he not do?

MR. BEEBE: Let's go to that.

Q Mr. Arning, what did you as vice president of the exchange at that time point to in January or February of 1969 with regard to McDonnell & Company's net capital violation?

A Acting on behalf of the chief executive of the

exchange, I queried the department of member firms as to what steps for remedy were being taken.

Q Was the situation remedied? Immediately, I mean?

A I can't go on recollection.

THE COURT: All right. That is an answer.

Q Sir, you gave an interview to a magazine in 1970, did you not, concerning the big board forcing weaker firms to --

THE COURT: Wait a minute now. Before you get into the substance of the interview let's see where we are at.

Is it in writing?

MR. BEEBE: Yes, sir.

THE COURT: Are you going to propose to put it in evidence?

MR. BEEBE: Yes, sir.

THE COURT: Let me look at it because you are referring to a document not in evidence at this point.

(Pause)

THE COURT: I take it this is being offered. Have you a position, Mr. Brooks?

MR. BROOKS: Well, what I would say now is dependent on Mr. Arning's authenticating it as accurate.

But I have an objection to portions of it which

cover subsequent events, those involving the lawsuit and actions the exchange has taken on it in the future.

THE COURT: I am going to sustain an objection to it being received in evidence at this point.

If you have specific portions of it, Mr. Beebe, which you feel come appropriately before us you may go ahead on that basis, but the article itself I would exclude.

MR. BEEBE: Could I ask the witness to do some authenticating to start with, sir?

THE COURT: I assume he will.

It is a dreadful picture, by the way.

THE WITNESS: I remember this article in Business Week, if that's authentication. It looks like that article.

Q In Business Week; right.

A Yes.

Q And this was the result of an interview that had been conducted of you in about July, 1970; is that right?

A Well, I don't remember when it was but it certainly was an interview with me, yes. I haven't read this obviously since the day it came out.

Q Just to fit a time frame, was it approximately July 18, 1970, that it was published?

A That's on here. I have no reason to know otherwise.

Q Did this interview and the article concern your activities as an active participant in regulating member firms for the New York Stock Exchange?

A Well, you know it is very difficult for me to characterize what it was. I didn't even want to be interviewed.

THE COURT: Sustained. It speaks for itself.

Mr. Beebe, are there any specific facts in there that have to do with the issues in this case as to which you want to ask this witness?

MR. BEEBE: Yes, sir.

THE COURT: Is such and such a fact so, and based upon whether that article refreshes his recollection or not, and using it in that fashion.

MR. BEEBE: Yes, sir, a number.

Q Sir, in your regulation of the member firms is it true that the stock exchange was taking the option away from the firms to run their own businesses and that it was a rude awakening to the member firms when you did this?

MR. LOFLIN: Objection, your Honor.

THE COURT: Yes. This is characterization. I won't permit that. Sustained.

Get into the facts, and the witness' manner of describing something in this article is not necessarily

relevant to this trial.

MR. LOFLIN: I have read this in the couple of minutes while you wasn't working and these other gentlemen were, and perhaps that gives me an advantage, but I object to any further reading of this article. If Mr. Arning wants to take a moment to read it, I think that might refresh his general recollection about some things. On the other hand, it may not. I see this article dealing with a number of subjects which are very far removed from any issue to this lawsuit. To the extent it deals with any issues in this lawsuit I think they should more properly be developed through the normal question and answer process.

THE COURT: Independently, that's what I was suggesting.

MR. BEEBE: I'm limiting my questions, particularly in this first question, to the question of control of the stock exchange over the broker firms which is at issue in this case.

MR.BROOKS: It is only an issue in this case as it pertains to McDonnell & Company.

THE COURT: And what they did and what they did not do.

MR. BEEBE: Of course, the exchange's control over all the brokerage houses of the New York Stock Exchange

of which McDonnell was one.

THE COURT: To the extent that McDonnell was in the rubric of that, it is. As to any other question it is not.

MR. BEEBE: I focused on that because it was in quotation marks.

THE COURT: But that's a characterization, Mr. Beebe. It is not a fact.

Q Can I ask you another question, sir, in terms of the conduct of regulation by the exchange over the brokerage houses. Did the stock exchange direct member firms who had problems as to how to run their businesses?

MR. BROOKS: I object to the question. Member firms are not in this lawsuit. McDonnell & Company is.

THE COURT: Sustained as to form in any event.

Q How did the top executives and the department of member firms under them exercise their regulatory functions over member firms including McDonnell & Company -- I will have to withdraw that. I will start that again.

Did the stock exchange, and I am talking about this era of 1968, 1969, your personal involvement, did the stock exchange exercise control over member firms with regard to disciplinary matters?

MR. BROOKS: I object to the form of the question.

THE COURT: Yes, I am going to sustain that objection. Although it is a close one.

MR. BEEBE: Excuse me?

THE COURT: I say it is a close one but I am going to sustain that objection particularly because we have had a lot of testimony here as to what input the stock exchange got, what restrictions were considered. There were a list of seven or eight of them handwritten on one exhibit as I remember it. The question was what was followed on that. So I will sustain the objection.

Q Sir, at your behest and at the behest of the member firms department were firms during the 1968, 1969 era ever merged out of existence?

MR. BROOKS: Same objection, your Honor. We are not here to litigate firms in general.

THE COURT: Yes, sustained.

MR. BEEBE: Sir, as to that very point I think that we are here in part to question the issue of whether the stock exchange had control over the member firms, including McDonnell & Company. The issue of control I do not believe can be so narrowly defined as to pinpoint it only as to one firm. If they have the power, then they could exercise it over McDonnell. The fact that they didn't exercise it over McDonnell is one of the issues in this case.

THE COURT: All right, Mr. Beebe, I think I agree with you. But going at it with what you are saying, you are going to have to lay a better foundation because you are going to have to establish under what circumstances they caused these mergers to come to pass. This was somewhat in the area of options, if I can capsulize a lot of discussion this morning.

MR. BEEBE: That's right, sir.

THE COURT: Then you have to lay a foundation as to the circumstances under which they would be exercising the options.

MR. BEEBE: That's right, sir.

THE COURT: This last characterization, which is a quote from this witness in an article, doesn't give us any foundation as to the circumstances.

MR. BEEBE: I am trying to build a foundation, sir.

THE COURT: But you have to go, it seems to me, at the other end and start from there. That's the roof. I don't think you have a floor.

MR. BEEBE: I will start with the floor.

Q You were in the regulatory area of the stock exchange; isn't that true?

A Yes.

Q 1968, 1969?

A Yes, I was.

Q And your primary concern, I suppose, is like a fireman, you only go to fires or you are only involved with firms that had problems; is that basically true?

MR. BROOKS: Objection, your Honor.

THE COURT: Sustained. Let's go to what he could do.

Q When you were confronted with a firm that had a serious net capital problem did you at times exercise control by the exchange to conduct mergers of the one firm with another firm?

MR. BROOKS: Object to the form of the question.

THE COURT: Yes. The word "control" in there is what Mr. Brooks is objecting to.

Has he ever in any situation of this kind where there was a net capital violation endeavored to cause a merger to come to pass; is that agreeable?

MR. BROOKS: Agreeable.

THE COURT: I would find that appropriate

in form.

Can you answer that?

THE WITNESS: I can answer it affirmatively.

Q Did you also have occasion in the courseof your activity at the stock exchange to require a firm to take drastic cuts in the volume of its business?

MR. LOFLIN: I object, your Honor. Drastic cuts relates to the volume of the business to begin with.

THE COURT: Sustained. Take the word "drastic" out and the question will be appropriate.

Q Take out "drastic." Can you answer the question?

A I wonder if I could have it read with that missing.

THE COURT: Again we are talking about net capital violations andthe question is whether in any circumstances of that kind you had occasion to cause a member firm to make a cut in its volume of business?

THE WITNESS: Yes. That was one of the restrictions.

THE COURT: Go ahead.

Q Do you recall if you in the summer of 1969 participated in the decision to require McDonnell &

Company to sell some of its branches?

MR. BROOKS: I object to the form of the question.

MR. BEEBE: These facts are in evidence, sir. It's not assuming something that's not already in.

MR.BROOKS: I dispute that. I think the evidence is that McDonnell & Co. itself made this decision to sell branch offices. It was not a decision that the exchange participated in or made.

MR. BEEBE: The witness could perhaps clear that up.

THE COURT: Let's find out what it is. Was there such a decision made, if you know?

THE WITNESS: Well, let me try to clear this thing. I testified a little while ago that when I learned of capital violations we moved to remedy. Now, the remedy lies with the member organization, McDonnell or anyone else, as to what avenues of pursuit they have available to them to generate the capital necessary to meet the requirements. And the department of member firms under Robert Bishop would meet with the member organizations and pursue with them the various

means available to them to raise capital.

In some instances we got cash or securities in 24 hours. In other instances assets were liquidated, seats were sold, branch offices were disposed of, other assets that had little or no capital value were translated into real capital value, but it was on the motion of the organization itself.

Q In other words, you are saying the exchange didn't go in and tell the organization to go out and raise capital, the organization made that decision itself?

A No.

MR. BROOKS: I object. That is not what he said.

Q Is that your answer?

A That isn't what I said. We told the member organization that you need X dollars to meet a ratio requirement. How are you going to do it?

Q Now, sir, were some of the things you were quoted in this article accurately quoting what you had said?

MR. LOFLIN: I object,your Honor.

THE COURT: Sustained.

Q Well, let me ask you as to a particular one.

THE COURT: Well, this puts it in effect in the record and in evidence before the jury on an exhibit that is not in evidence.

MR. LOFLIN: It was my understanding that the Court had ruled this article could not be used in this manner but that any direct question dealing with the issues in the suit could be brought out now in question and answer, the usual way.

THE COURT: Right.

Q Let me ask you this then, sir: Was it your position in 1969 that if a firm had a net capital problem it either had to get so strong as to get beneath the requirements, that is, the 2000 per cent level, or get out of business?

A You said it, but I would agree with it.

Q Did you ever issue a retraction or write a letter ot Business Week disputing anything that was in this article?

MR. LOFLIN: Objection, your HOnor. It is irrelevant.

THE COURT: Sustained.

MR. BEEBE: I'm still struggling about getting the whole article in and the question was pinpointed to that one area.

THE COURT: The last one?

MR. BEEBE: Yes. To find out whether there was any dispute about the validity of what he said in this article.

THE COURT: Yes, but there is no article to be disputed at this point, so the objection is sustained.

Q Sir, was it your position in 1968 and 1969 that when a firm reached the 20 to 1 ratio it would be forced out of business in a matter of hours?

MR. LOFLIN: Objection, your Honor.

MR. BEEBE: I believe as he sits here now that is a perfectly valid question.

THE COURT: Yes. I will overrule that objection.

Was that your position in 1968 and 1970?

THE WITNESS: Thats's not a practical description.

Q Did that approximate your position?

A I don't recall ever having used those precise words.

Q I am asking did you use words or substance to that effect?

A I'm very graphic in my language and I can use license when I'm dealing with an interviewer such as

this to get a point across and I may very well for emphasis have used something generally descriptive of that. That wouldn't be abnormal for me. But that is not a practical answer.

Q Was it your position that if capital was a problem in a firm in 1968 and 1969, the firm was usually allowed no more than a week or two to get it in line?

A Yes, I think that's right.

Q Was the grace period longer for operating losses?

A I don't follow the question.

Q I will withdraw the question.

Did the New York Stock Exchange enforce its net capital rule against McDonnell & Company in early 1969?

MR. BROOKS: I am going to object on the basis of the witness' answers that he didn't recall the capital position of McDonnell & Company in January and February.

MR. BEEBE: The question goes to the heart of the case.

THE COURT: Let's see what his recollection is as he sits here on the stand today.

(Question read)

A The stock exchange enforced its capital rule, yes.

Q Sir, I think we have previously marked Exhibit 74, an exhibit dated February 7, 1969. I show that to you to remind you that according to the analysis of Mr. Spies of the October 31, 1969 financial analysis dated February 7, 1969, the ratio was 2017 per cent -- 2717 per cent, which is in excess --

MR. BROOKS: I believe Mr. Spies testified this was the examiner's analysis which hewas simply reporting on.

THE COURT: As of October 31, 1968.

MR. BROOKS: It was not Mr.Spies' analysis, right.

MR. BEEBE: I will abide by that correction.

THE COURT: What is your question based on that, Mr. Beebe?

Q I had asked you questions about January 1969 and the information available at that point to you at the top levels of the exchange. Were you also made aware in February, and I just use this as a starting example, and March and April of 1969 that exchange examiners, as Mr. Brooks has corrected me, and others in

the exchange coordinator department continued to find McDonnell & Company in violation of the rules.

A I don't recall what I knew then.

THE COURT: Mr. Beebe, are you going on to something else?

MR. BEEBE: I was going to, your Honor.

THE COURT: Ladies and gentlemen, we will stand in recess until 10 o'clock in the morning. I have judge's meeting that I must attend.

10 o'clock tomorrow morning. We are sitting a half day tomorrow, as you will recall.

(Adjourned to May 9, 1975, at 10 a.m.)

MARGARET MARY MC DONNELL MURPHY, et al.

vs. 71 Civ 461
71 Civ 1940

MC DONNELL & CO., INC., et al.

May 9, 1975
10:00 a.m.

Trial resumed.

- - -

(In open court; jury present)

L E E D. A R N I N G , resumed.

CONTINUED DIRECT EXAMINATION

BY MR. BEEBE:

Q Good morning, Mr. Arning, at one point yesterday we were asking about suspension of firms under Article 13 of the exchange constitution, as far as 1969 is concerned. There has been testimony elsewhere that Weiss & Company was suspended under that article in that era.

Would that refresh your recollection that

Weiss & Company was suspended?

A No, sir. It doesn't refresh any recollection, and I would suspect that Weiss & Company was just very recently.

Q Excuse me, sir. Well, the word "suspension" caused me to ask you not to go into there because we were asking about particular facts.

You don't recall Weiss & Company in that era?

A Not at any point when I was with the New York Stock Exchange.

Q Yesterday, sir, we had testimony from you about if a firm failed to resolve an apparent net capital violationwithin a short period of time, say a week or two I believe was mentioned in your testimony.

What is the normal procedure if a firm fails to resolve a net capital violation within a week or two? I'm talking about the era of 1968, 1969.

A The procedures of the exchange are to remedy the capital deficiency in one manner or another.

Q Yesterday we asked you about an article and I neglected to have it marked for identification. I ask it be marked now.

(Plaintiffs' Exhibit 85 was marked for

identification)

Q If I could direct your attention to the paragraph beginning at the bottom of the center column. Do you see where I am?

A Yes, but I wonder, counsel, if I might ask your indulgence --

THE COURT: Wait a minute, wait a minute. The normal procedure is to ask the witness questions that are relevant to these issues, and then if there is a failure of recollection or an alleged contradiction you may use the exhibit. First put to him the fact that you want to elicit. If you want to use the exhibit for any of the normal purposes, you may then go to the exhibit.

I don't wantyou to direct his attention to anything here to establish a foundation for its use.

Q Sir, the question was directed particularly at what the exchange does if a firm does not get its capital in shape within the one to two weeks that were mentioned yesterday.

A I think I just replied.

Q I believe you did give a reply, sir. Now I'm asking you to look at that first sentence that I have directed your attention to and ask you if it refreshes

your recollection that the exchange sees to it that the firm goes out of business? That is my question. Does that refresh your recollection?

MR. LOFLIN: I object to the question as a matter of form, your Honor. It's leading and it seems to me to be a misuse of this proposed exhibit.

THE COURT: Yes. I sustain the objection on that latter ground.

Q I believe, sir, and the reason I am tendering a piece of paper to refresh yourrecollection is that there is a quotation --

THE COURT: No, Mr. Beebe, I don't care about the prior quotation. I am interested in getting facts from this witness' mouth now. If he said something at another time that you claim is inconsistent or is needed to refresh his recollection, you can go to that afterwards. But you asked him a question about what happens when they find a capital deficiency and he said we try to remedy it in "one manner or another."

I submit to you, sir, the next question is what happens if it's not remedied. The next question is not to give him a document and ask him to read from an article and ask him to say what happens if it's not remedied.

MR. BEEBE: I will adopt that question precisely.

BY MR. BEEBE:

Q Now, what happens if it is not remedied in a week or two, if I can put it that way?

A The member organization of the the exchange, whoever it may be, is fully conversant and comprehends the exchange's capital requirements. It knows that at the direction of the exchange, if it must meet capital requirements, steps must be taken to do it.

Now, the election is the member organization's; do they sell their seats? Do they liquidate proprietary positions? Do they transfer out customer debits that have offsetting borrowings, all at reduced liabilities and liquidate assets that might otherwise not have capital value.

Now, that's a decision that the member organization itself makes, and it has to make those within the context of its business frame, whatever that might be at that point in time.

MR. BEEBE: May I have the question read back, please? I don't think it is at all responsive.

THE COURT: It is responsive as far as it goes. Further questioning along this line is what happens if within a given exchange's time frame imposed upon a member firm it does not meet the capital requirement.

THE WITNESS: Well, there would be a point in time

if it could not take its own liquidating steps to accomplish capital requirements, steps would have to be taken to suspend it.

BY MR. BEEBE:

Q Sir, at that time -- and my questions are always directed to the 1968, 1969 era unless I say otherwise for some particular reason -- did the New York Stock Exchange require correction of net capital violations within, at most, one week?

A I don't recollect the time period. It may or may not have existed. I just don't know.

Q Perhaps I could refresh your recollection by reading from the transcript of your deposition, pages 181 and 182:

"Q Once the New York Stock Exchange had learned of the violation or the alleged violation of Rule 325 capital ratio, can you recall any instance where the member firm did not rectify the violation within a one week period?

"A Well, that's what I answered earlier.

"Q Your answer was what?

"A I don't recall.

"Q Do you recall what time period was allowed a member firm to rectify?

"A The exchange didn't mess around with capital

violations. We remedied it, period.

"Q Give me, if you can, a time within which you had to do it.

"A Well, Duke Jones used to get on the telephone and give a guy 20 minutes, an hour, an hour and a half. What do you want?"

Is that the time frame, sir?

A I don't know what that's got to do with your earlier question, counselor.

Q I am asking you if that is the time frame within which net capital violations were supposed to be rectified according to the New York Stock Exchange and your own testimony?

A I have a great departure from the question you asked me a moment ago to which I replied and what you just quoted me saying a year or so ago.

Q Is that what you testified to a year or so ago?

A I certainly said that, yes.

Q Was it true?

A I was being descriptive of what occurred at a particular point with Duke Jones having run that section of the department probably in 1961 or 1962.

Q I am reaching for a time frame, sir. Was the time frame a week, the time frame that was in operation?

A Counsel, the exchange was very, very --

MR. BEEBE: I believe that calls for a yes or no answer.

THE COURT: No, it does not. That is what he is trying to say to you, I think.

THE WITNESS: May I proceed?

THE COURT: Please do.

A The exchange were very emphatic in the enforcement of its capital rules, and it gave whatever the minimum time necessary to accomplish it might be.

In the period that I was in the New York Stock Exchange, and let's say from 1955 to 1965, we felt with a fixed set of circumstances that existed around us, and capital requirements could be resolved literally by a phone call by the head of the department, the department that Mr. Jones then ran.

At later points in time, with the more complex problems that arose on Wall Street that affected member organizations, not alone from their own point ofview but from the standpoint of what was done elsewhere, the fail problem was not a single firm's problem; the transfer problem was not a single bank's problem; the dividend problem was a community problem. The issues changed dramatically; and based on the individual circumstances that

prevailed at each member organization, a resolution of that capital problem was treated, and I would be happy to the best of my recollection to go into any one of them as to how and when we treated them, and why.

Q The questions I am attempting to pose go into the normal application of the rule.

Now, I'd like to ask you, sir, what did you mean when you testified two years ago that you could not recall any instance where a member firm did not rectify the violation within a one week period What did you mean when you said that?

You were asked the question:

"Once the New York Stock Exchange had learned of the violation or the alleged violation of Rule 325 capital ratio, can you recall any instance where the member firm did not rectify the violation within a one week period?

"A Well, that's what I answered earlier.

"Q Your answer was: I don't recall any."

My question simply is, is that still your answer today?

A Yes.

Q Sir, was T. Murray McDonnell a friend of yours?

A I have a lot of friends and I don't know how one defines these sort of things. He was known to me. I knew him

I don't know how to put it.

Q Was he a personal friend of yours?

A No, I wouldn't say he is a personal friend. I never saw him off duty here, so to speak.

Q I would like to come back for perhaps the last time to the question of lettered stock. I believe that you testified before that the exchange did not permit the use of lettered stock as good capital.

A I don't have any recollection of testifying to that at all, but if you say so I will accept it.

Q Is it true that the exchange did not permit lettered stock as good capital at that time?

A Would you define lettered stock for me, counselor?

Q Lettered stock, restricted stock - are those terms familiar to you?

A Yes, but I want to be sure we are talking about the same thing.

Q We have had testimony that there is stock to which either a legend is placed across it that it is not to be resold because it is not registered with the Securities and Exchange Commission, or sometimes a letter is attached to it to the same effect.

A I would think that would not have capital value.

Q Under the net capital rule I believe you have also

testified that only stock that was free and available for sale was usable as good capital.

A I don't dispute the philosophy but I don't recall the testimony. That is my problem.

Q As long as you are still saying that today.

Now, sir, Mr. Newman testified, and there was an exhibit introduced in the course of his testimony to the effect that he turned down a request by McDonnell & Company in the middle of 1969 to use lettered stock as good capital in July, 1969.

You changed that rule, did you not?

MR. BROOKS: I object to the question.

THE COURT: What is the basis of your objection?

MR. BROOKS: Mr. Beebe's statement says "You changed that rule, didn't you?" I don't think there is a rule involved --

THE COURT: Yes, you better lay a better foundation.

The objection is sustained.

BY MR. BEEBE:

Q You just testified that lettered stock is not usable as good capital. I am asking you if you made any special change of that statement or that position in the case of McDonnell & Company in the middle of 1969?

A I have no recollection of any such thing.

Q I show you Exhibit 57, which has previously been marked in evidence. It states in part - it is just a one page memo about a joint telephone hook-up --

MR. BROCKS: Is that in evidence?

MR. BEEBE: 57 in evidence.

Q "Mr. Arning decided that for capital purposes up to 25 per cent of the quoted market price of comparable securities could be allowed. In this case it would mean about $650,000 since the corporation has estimated the market value to be $2,600,000, and the bank is apparently willing to loan 25 per cent of that amount of $650,000.

Mr. Arning made no mention of the length of time this treatment would remain in effect."

Does that refresh your recollection that in McDonnell's case you did make an exception?

MR. LOFLIN: I object to the form of the question.

THE COURT: Overruled.

You may answer.

A Are there any more details with respect to this that I might have available to me? What security are we talking about? How many shares? Where is it listed? What bank?

Q I don't have the exhibit number on this but I believe the July 22, 1969, memorandum of Mr. Newman, which

is also marked in evidence - this was the one where Mr. Newman turned down the same request and Mr. Lindh said-- I better make sure it's in evidence.

I can give you what is called the tag copy that has the exhibit number right on it. It is number 56.

A Well, I just raise the number of questions which come to my mind, none of which seem responded to in this.

Q I agree with you. My question is, did you make an exception for McDonnell & Company in July, 1969, as to giving --

A It's impossible to answer, counselor. I didn't write this memorandum; I don't know what some of the terms mean, but I would be delighted -- I can speculate what might have happened --

Q No, sir.

A -- but I would like to see the facts and tell you just exactly what I did, but I need to know the security, where it was listed, its price, what the bank was lending --

Q Excuse me, sir, there is a chance for cross-examination, and your counsel will well put in a case too.

I am just asking you to read this one sentence, or the whole memo and the other memo that I have handed you that is in evidence, the sentence I am referring to and ask you for your recollection is:

"Mr. Arning decided that for capital purposes up to 25 per cent of the quote of the market price of comparable securities could be allowed."

A I have a distinct recollection, counsel, that the time of my deposition I didn't understand this sentence. I didn't know what comparable securities meant and no one was able to cast any light on it, and I am in no different position today than then.

Q Do you recall 25 per cent, a 25 per cent value being attributed to lettered stock from McDonnell & Company in that era by you and in terms of dollars and cents, the memo says $650,000, since the corporation has estimated the market value at two million plus?

Does that help you at all?

A No.

Q You can't provide any explanation as you sit there?

A I could. I could speculate and guess at what happened here, and I think this is what is addressing specifically what I said earlier when the exchange directs the firm to improve its capital position. These people were attempting to take a security that had a full capital haircut and translate it into some value; and, if, indeed, a bank was going to lend them money on that, that may have been a way to accomplish it, but I would need some facts today

that were at least equivalent to what I had in front of me then to make the same decision.

Q In other words, absent the things you just mentioned as factors, or perhaps some others, normally one would not give a 25 per cent value to lettered stock; is that fair to say, in 1969? And I am basing that question on the very questions you were asked just now--

THE COURT: Now Mr. Beebe, you are getting much too complicated. Stick to the first part.

MR. BEEBE: Yes.

Q Normally, sir --

THE COURT: Mr. Reporter, would you read the previous question.

(Question read.)

Q And normally one did not give --

THE COURT: He heard the question.

A I heard the question. I will agree that is so.

Q The last sentence of that memo says:

"Mr. Arning made no mention of the length of time this treatment would remain in effect."

Do you recall if the treatment remained in effect for any length of time?

MR. BROOKS: Your Honor, I object. The witness has already said he did not recollect the event.

THE COURT: I assume that is included in.

MR. BEEBE: It is subsumed in the question.

THE COURT: Well, if he doesn't recall the event at all he will not recall --

MR. BEEBE: I am not sure that is what he testified to. He couldn't recall the reason why the 25 per cent exception was given, was his testimony.

THE COURT: Mr. Arning, look at that last sentence. Does that refresh your recollection in any way as anything having to do with the subject matter?

THE WITNESS: I can't answer as to this specific-- It isn't very specific, but this situation, I can tell you what that ought to mean in the context of our daily appearance.

THE COURT: Objection sustained.

Q You are familiar with MF memo, aren't you? Member firm memoranda or circulars they were called at that time?

A You mean the procedure of utilizing them?

Q No. Just the memos themselves. We have some introduced in evidence.

A Yes.

Q Do you know if an MF memo was ever issued with regard to lettered stock giving capital value to lettered stock?

A I don't remember. Member firm circulars numbered the hundreds each year.

Q You don't recall one addressed to that particular subject?

A Not offhand.

Q Now, sir, I would like to shift into a new area. This is trust funds. We haven't had any testimony on that and I am going to ask you some questions.

Was there a trust fund established by the New York Stock Exchange for customers of member firms? I am going back to 1963, 1964 in this question.

A The membership of the exchange created a special trust fund by amendment to the constitution in the early 1960s, at the time shortly after the assassination

of President Kennedy, which fund was to be utilized at the discretion of the trustees of the special trust fund.

Q Was it established after the Ira Haupt incident?

A It occurred after Ira Haupt, yes.

Q Was there some relation between the two events?

A I don't know how to answer that.

Q Did the Ira Haupt incident lead in any way to the decision to create a trust fund?

A Well, the Ira Haupt problem entailed the exchange raising funds to satisfy customer claims. And if your question is did the problem raised by Ira Haupt cause the exchange toconsider that it might want to have some different methodology, I guess the answer is yes.

MR. BROOKS: I am going to object to this line of testimony. I don't see that it's relevant to the problems about regulating McDonnell & Company.

THE COURT: I will permit it. Overruled. Go ahead.

Q Sir, what is the source of the funds for -- what was the source of funds for this special trust fund?

Where did the money come from?

A Well, my recollection is the amendment provided that the exchange could levy whatever charges were necessary to raise the funds.

Q It's a simple, direct question. It came from the members of the exchange, did it not?

A No. If you will let me finish.

Q I'm sorry.

A But I think without exception, or there may have been one exception, the exchange funded the trust fund from its own resources.

Q What were its resources?

A It's profits, a rather substantial building fund that had been created over a period of time. Those are two basic areas that come to mind. Maybe that was all.

Q Now, up until or during the paper crunch, 1968, 1969, did the exchange go to this building fund that you mentioned and transfer the building fund into the special trust as a source for funds? Was that what you were alluding to a minute ago?

A Well, at one point, and I don't know when it was. I don't recollect precisely, we did utilize those funds, yes.

Q What was the source of the building fund?

A The building fund had been accumulated over a period of time. I'm dim,but I think from several sources. One was an added charge for certain floor facilities that were utilized, and there was some other specific sources. The fund was not created out of the blue. It was built purposefully and from a variety of member -- of exchange income sources, adjustments made to this income sources and then funnelled precisely into the building fund.

Q Andthe surcharge was imposed on the members who were trading through the exchange; is that correct?

A What is your charge?

Q The charge that you mentioned being imposed on top as one of the sources for the building fund.

A I don't think surcharge is accurate. For example, one of the things that happened, a booth rate that had been X dollars a month became X plus three.

Q And the X plus three is charged to the person who is using the booth; is that right?

A Correct.

Q The person who is using the booth is a member of the exchange?

A Correct.

Q Now, are we talking in a magnitude of $35 to $50 million in terms of the building fund?

A At its height?

Q When it was transferred to the trust fund.

A Well, mechanically, counsel, I don't think it went over in one lump sum.

Q Can we lump them together though?

A If your question was what is my guess as to the height of the building fund at its maximum, I could say someplace in the vicinity of -- it's dim, but I would say $40, $45 million.

Q And of that $40 to $45 million hor much ultimately went over to the special trust fund?

A I believe ultimately all of it did.

Q Now, when McDonnell & Company went into liquidation the special trust fund paid some monies to the customers, did it not?

MR. BROOKS: Object to the form of the question. Leading.

MR. BEEBE: Well, adverse witness.

THE COURT: Overruled.

Q Sir, do you recall that you previously testified --

THE COURT: You have a question pending.

Mr. Beebe. Let him answre it.

A Would you be good enough to repeat it.

(Question read)

THE WITNESS: I'd like to describe the procedure here, your Honor, if I might.

MR. BEEBE: I am just going after the dollar amount at the moment.

THE COURT: Can you answer this question yes or no the way it is put to you?

THE WITNESS: I'll answer it yes, but it isn't precise.

THE COURT: All right.

Q Let me ask you what the dollar amount was that was paid to McDonnell & Company customers out of the special trust fund?

A I'm not sure. I'd say the vicinity of $7 or $8 million.

Q If I said $9 million or slight above that, would that still be within your recollection of the amount?

A It would sound high, but I wouldn't say you were wrong. These figures are published. They are readily available.

Q Now, I am going to ask you a general question about the effects on the trust fund, claims

against the trust fund of two different brokerage houses, brokerage house A and brokerage house B. Brokerage house A has 30 branches -- say 26 branches approximately. It goes out of business and makes claims against the trust fund.

Brokerage house B has three branches, it goes out of business and makes claims against the trust fund. What is the difference in effect on the claims against the trust fund of this A and B?

MR. BROOKS: I object to the form of the question, your Honor. The witness has testified that this is an entirely discretionary trust fund. I don't think there are any such things as claims.

THE COURT: I don't see the relevance of it either. I sustain it.

MR. BEEBE: May I answer on two points? One, I'm asking about the claims, not the exercise of the discretion.

THE COURT: I appreciate that.

MR. BEEBE: The second part of it is that relevance, brokerage house A is McDonnell & Company in January 1969 --

THE COURT: No, no. If you are going to have a hypothetical limited, you don't really have a --

Q In general terms, sir, I will rephrase the question this way: Is there a difference in the size, the dollar amountf of claims against the special trust fund depending on the size of the brokerage house that goes out of business?

MR. BROOKS: I object to the form of the question.

THE COURT: Overruled. The answer will be yes or no, I would assume.

Maybe it can't be answered with a yes or no.

Q Can that be answered yes or no, sir?

A You know, what do you mean size? You used number of branches in your description to me a moment ago which is very meaningless. If that's what you mean then the answer is no.

Q Can I ask it in terms of number of accounts, would that be more meaningful?

A What type of accounts?

Q Customer accounts who would have claims, who would be entitled to make claims against the special trust fund.

MR. BROOKS: I object to that question. The testimony is completely to the contrary.

THE COURT: Sustained. Gentlemen, come

to the side bar, please.

(At the side bar)

MR. BEEBE: May I say first I am not going to pursue this any further?

THE COURT: All right.

(In open court)

Q Sir, you restified yesterday that a firm over the 2000 per cent limit had to get under the limit or get out of busihess. We have had some more testimony about that this morning. Was McDonnell & Company an exception to that?

A Not that I am aware of.

Q You also testified yesterday that if capital was a problem, and you testified further this morning about it, there were time limits to act. Was McDonnell & Company an exception?

A No, sir, I don't believe so.

Q Did there come a time in 1970 when the exchange issued a membership bulletin on self regulation over the prior three years, including McDonnell & Company?

A I don't recall. Could have.

Q I show you this document entitled "Special Membership Bulletin, October 1970."

(Plaintiffs' Exhibit 86 was marked for

identification)

A (Reading)

Q Sir, did that report involve McDonnell & Company among others, the top of the second page?

Were you aware of that report?

A You mean this memorandum, this bulletin?

Q Right. Signed by Robert W. Haack.

A I would certainly have had to be aware of it, yes.

MR. BEEBE: I offer this as the next exhibit.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 86 was received in evidence)

MR. BEEBE: I'd like to read from the third paragraph:

"The paperwork crunch of the 1968-1969 and the severe profits squeeze that followed required the exchange to intervene actively at one time or another in the affairs of the 196 member firms, more than half of all member firms doing business with the public."

Q Was McDonnell & Company one of those, sir?

A Yes, sir.

Q Next paragraph starts "The 196 total represents on an unduplicate basis 105 firms that at one time were on exchange restrictions because of severe paperwork problems."

Was McDonnell & Company one of those?

A Yes, sir.

Q The top of the second page, "A question often asked is why did the exchange allow a few major member firms to continue in business despite critical paperwork and capital problems. This was the case, for example, in three major firms, Dempsey Tegler, McDonnell & Company, and Blair & Company."

Were the problems in the case of McDonnell &Company violations of the --

MR. BROOKS: I think counsel should have finished the sentence.

MR. BEEBE: I would like a chance to ask the questions and there's plenty of time to cross on this document. I am asking about McDonnell & Company.

THE COURT: Well, I think it would be appropriate to finish the sentence you were reading.

MR. BEEBE: Very well, sir. I will read the whole thing again.

"A question often asked is why did the

exchange allow a few major member firms to continue in business despite critical paperwork and capital problems. This was the case, for example, in three major firms: Dempsey Tegler, McDonnell & Company and Blair & Company, with a combined total of 165 customer accounts."

THE COURT: 165,000.

Q My question is, sir, did the critical paperwork, critical problems in the case of McDonnell & Company add up to violations as we saw yesterday in the charge memo?

MR. BROOKS: I object to the question.

THE COURT: Let me have it read back, please.

(Question read)

THE COURT: Yes, I am going to sustain the objection to that question.

MR. BEEBE: I will rephrase it, sir.

Q Were the problems referred to in this special membership bulletin signed by the president of the stock exchange, as far as McDonnell & Company was concerned, did those problems amount to violations?

A I don't think so, no.

Q Do you recall the charge memo yesterday, the violations that were found in that by the exchange?

A Yes.

Q For the period starting in October 1967; do you recall that?

A Yes.

Q That was Exhibit 83.

Was McDonnell & Company, according to the charge memo, and I show it to you, in capital violation, paperwork violation and various other rules that are alluded to there?

MR. BROOKS: If counsel's question is simply asking the witness to read the exhibit, I suggest the exhibit is the best evidence.

THE COURT: Let's find out whether it is. Is that the basis for the question?

MR. BEEBE: The question is -- I'm laying a basis from that exhibit.

Q Now, was McDonnell & Company in violation of the rules, capital rules and books and records and the other rules, during 1967 and 1968 and 1969?

A Counsel, we got a problem here. If you are talking about this thing and the first paragraph which you first read on page 2 of this memorandum, because I answered your question that the capital problems here did not mean capital violations. And I stick to that answer.

Q I'm asking you --

A This is a different issue.

Q Let's talk about the different issue problem.

A You have to get me on the right track here.

Q Exhibit 85, the charge memo --

A I don't have 85; 83?

Q 83, the charge memo. Do you have that?

A Yes.

Q Was McDonnell & Company in violation of those rules in 1968 and 1969?

MR. BROOKS: Your Honor, again I think the exhibit speaks for itself.

THE COURT: Objection sustained.

MR. BROOKS: As exhibits they provide a detailed schedule.

THE COURT: Objection -ustained.

Q The reason I hold these two at the same time is they areboth dated October 1970, both the same month. My question is what capital problems was Mr. Haack referring to that are any different from the violations that the charge memo is referring to?

MR. BROOKS: I object tothe question.

Q If any.

MR. BROOKS: Only he can tell us that, Mr.

Haack, unless Mr. Arning wrote this.

THE COURT: Sustained.

Q You testified that the capital problems in the special membership bulletin did not amount to violations of the exchange rules. What was your basis for saying that a minute ago?

A Because there is a marked difference between a problem and a violation.

Q In this case what was the difference between a problem and a violation?

A Not having written this I don't know. But I can tell you there is a marked difference between the two.

Q In the case of McDonnell & Company was there any differnce in the world between the two?

THE COURT: Mr. Beebe, this witness is saying the word "problems" is on an entirely different track. He is saying the word "problems" in Exhibit 86 has a certain meaning according to the dictionary which is different from the dictionary meaning of the word violations. That's all I understand him to be saying.

THE WITNESS: That's correct.

THE COURT: Nothing more.

Q What I am saying and asking --

THE COURT: You have to get off on a foundation that will permit you to get to the question you want to ask and you are not there.

Q I take it, sir, that you do not know as you sit here of any difference in substance between McDonnell's capital problems in 1968 and 1969 and the facts which resulted in a finding of violations?

MR. BROOKS: I object to the form of the question.

THE COURT: I sustain the objection tothat.

Mr. Beebe, may I suggest that you have your facts in evidence in the charge memorandum from which you could argue the case that this was minimally profitable.

MR. BEEBE: I shall do that. Capital problems I believe is a euphemism. I'm asking this witness if I am wrong.

THE COURT: You argue that to the jury if you wish. I sustain the objection.

Q Did the exchange permit McDonnell & Company to continue in operation despite the capital problems alluded to in Exhibit 86?

MR. LOFLIN: Objection, your Honor. We have been through all this.

THE COURT: Sustained.

Q Turning to the attached report that's part of Exhibit 86 at the bottom of the unnumbered page 3 of that report there is a paragraph that begins "For example." I would like to read from that.

MR. BROOKS: What's the heading on that again?

MR. BEEBE: "Practical self regulation."

Q "For example, in the case of three major member organizations the exchange found itself facing situations where normal application of rules would have meant possible loss for many thousands of customers and potential chaos in the industry."

Do you know what was meant by the phrase "normal application of the rules"?

A Not precisely. I think it's a generalization.

Q Was there normal application of the rules with regard to McDonnell & Company in 1968 and 1969, Mr. Raning?

A I do not know of any departure from the normal application of exchange rules as applied to McDonnell & Comapny, Incorporated.

Q Turning thepage, sir, there are only three firms named. Leaving aside Dempsey Tegler and Blair & Company, McDonnell & Company is the third.

A That wasn't your question to me.

Q My question is did the exchange apply normal application of the rules to McDonnell & Company in 1968 and 1969?

A And I answered that I am not aware of an occasion where it did not.

Q Let me ask you about this memorandum. Do you recognize Mr. Haack's signature on that?

A Yes, I do.

Q And was this circulated to all members and allied members?

A Well, that's the legend that it's directed to, and I have no reason to suspect that it did not go to them.

Q Do you know of any prior announcement by the exchange that it had not made normal application of the rules in the case of McDonnell & Company?

A I just testified I don't know of any at all, so I can only reiterate that reply.

Q Apart from what you read here had you ever heard before anywhere or read anywhere that the exchange did not apply the rules in the normal way asto McDonnell & Company?

A No, I do not.

MR. BEEBE: No further questions on direct of this witness.

THE COURT: All right.

CROSS EXAMINATION

BY MR. BROOKS:

Q I just have one question, Mr. Arning. I show you a document entitled "Deed of trust," and ask you if that is the deed of trust of the trust fund that you spoke about earlier?

MR. BEEBE: May I have a copy of that?

MR. BROOKS: I only have one copy. I didn't expect this to be an issue in the case. I will get you one.

MR. BEEBE: Objection to counsel's characterization that it's not an issue in the case.

A Yes, it appears to be the deed of trust.

MR. BROOKS: I offer this in evidence.

(Pause)

MR. BEEBE: This is a 1964 document which appears to bear no relation to this witness. I don't know if he has given any foundation to introduce it, and I would object to its coming in in this case.

MR. BROOKS: Your Honor, there has been testimony that the trust fund was created at about this

time and it must have been done by deed of trust.

MR. BEEBE: I just say that this witness perhaps is not the best media --

MR. BROOKS: He said he can identify it.

MR. BEEBE: I don't remember him really identifying it except to say that it appears to be it.

THE COURT: We are talking about triple III for identification. What do you know about this?

THE WITNESS: The deed of trust?

THE COURT: Yes. Did you have any relationship to that, any awareness of it, any knowledge of the authenticity of triple III for identification?

THE WITNESS: This was created at the time I was an officer of the exchange. One of the departments that created it reported to me at the time. I have worked with the deed of trust and filing it with various states and other places, and of course the liquidations that took place.

THE COURT: Objection overruled.

(Defendant Stock Exchange Exhibit III was received in evidence)

MR. BROOKS: I have no further questions. I may recall Mr. Arning, if necessary, on the defendants' case.

REDIRECT EXAMINATION

BY MR. BEEBE:

Q Sir, do you recall testifying that nobody would even dream of doing anything with regard to suspending a company?

MR. LOFLIN: Objection to the form of the question.

THE COURT: Sustained.

MR. BROOKS: I object to the scope ofthe question. It has nothing to do with the deed of trust.

THE COURT: Sustained.

MR. BEEBE: It's on the trust funds.

THE COURT: Let's put it without reference to past testimony. Just ask him direct testimony bearing on this one exhibit that was offered.

MR. BEEBE: I can ask him a direct question, sir. It's on the trust fund, or the trust itself.

THE COURT: Go ahead.

Q You have testified thatyou were a man engaged in the New York Stock Exchange's regulatory function with regard to brokerage houses. In discharging that function did you take into account the effect that the regulatory

decisions would have on claims against the trust fund?

MR. BROOKS: Object again to the form of the question. I don't think there is any basis for saying there is any such thing as a claim against a discretionary trust fund.

MR. BEEBE: There certainly can be a claim against it. That's precisely what happened here.

THE COURT: I will permit the question to be put.

You may answer it appropriately.

A May I have the question?

THE COURT: Read it, please.

(Question read)

A I did not.

Q Let me read from your deposition pages 304 -- 305, rather.

"Does Mr. Haack have the authority to summarily suspend?

"A Nobody would suspend any organization without going to the board of governors. Nobody would even dream of a suspension without first providing for the settlement of open contracts on the floor, and nobody would even dream of doing anything unless there were adequate trust funds to take care of the customers'

property on board there. None of those things were on the floor there."

Do you recall giving that question and answer?

A You just read the answer and I'm sure I said it. I stand by it, as I do my other answer.

Q And perhaps, sir, you could explain to us what you meant when you said "Nobody would even dream of doing anything unless there were adequate trust funds to take care of the customers' property on board"?

A Your first question to me was at any time did I look over my shoulder and look to the trust fund when I was making a regulatory decision. The answer to that is absolutely no, at no time.

The question was directed to me in the deposition related to a sequence of events resulting in a suspension when matters were going to go before the board of directors. My answer at that point there would be a whole mass of information presented to the board if that event transpired. They are separate and distinct. Both of them are accurate.

MR. BEEBE: No further questions on redirect.

MR. BROOKS: One question.

RECROSS EXAMINATION

BY MR. BROOKS:

Q At the time McDonnell & Company went into liquidation, I believe you testified that seven or eight or maybe nine million dollars of trust fund assets was eventually used at the discretion of the trustees to assist McDonnell & Company. My question to you, sir, is at the time McDonnell & Company went into liquidation were there adequate trust funds in the trust?

MR. BEEBE: Objection. Beyond the scope of the direct. Leading.

MR. BROOKS: It's from the very testimony counsel just read.

THE COURT: Overuled.

Q You may answer the question if you have it in mind.

A I have no recollection.

MR. BROOKS: No further questions.

THE COURT: You may step down, sir.

MR. BEEBE: I would ask that Mr. Arning remain available on call in case he is needed on the plaintiffs' case in rebuttal after the defendants' case.

THE COURT: Well, I assume thathe is subject

to the processes of the Court like any other witness.

I trust you will be available, if necessary.

MR. BEEBE: He is appearing under subpoena.

THE WITNESS: I will, sir.

THE COURT: Mr. Arning has agreed to remain available.

(Witness excused)

MR. BEEBE: We only have one witness left. Would this be an appropriate time to take a recess?

THE COURT: You have one further witness on your case?

MR. BEEBE: As of this point.

THE COURT: We will stand in recess, ladies and gentlemen.

(Recess)

[This page unnumbered and left blank]